To [illegible] — with [illegible] regards
Joseph J. Scott

THE INCOME TAX

AND

OTHER FEDERAL TAXES

By

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An Authoritative Analysis, Simplification and Illustration of the Exacting and Perplexing Requirements of the United States Tax Laws.

Press of
KOHNKE PRINTING COMPANY
233 Pine Street
San Francisco, California

FOREWORD

This book is intended for reference. It has been written and arranged for the use of the taxpayer who must comply with the exacting requirements of the Federal Revenue laws but who has not had opportunity to follow the official interpretation and administration of their many intricate and involved provisions.

It is suggested that the index be consulted for reference to the subject regarding which information is desired; in this way an answer may be found immediately to the question in the taxpayer's mind, without unnecessary reading.

Toward the back of the book will be found the text of the laws, which also can be consulted, according to the direction of the index, when the taxpayer would see whether in his own opinion instructions are in compliance with the law.

For the reason that "net income", as ascertained under the provisions of the Act of September 8, 1916—the general Income Tax Law, is taken as the basis of computation, not only of the combined Income Taxes, but also of the Excess Profits Tax, it has been deemed advisable to go very thoroughly into the requirements of that Act.

The Act of September 8, 1916, as amended, has become, by a wide margin, the most important of Federal tax laws. It is the fundamental statute. With respect to it the War Income Tax law is supplementary, and the Excess Profits Tax law occupies a position of relationship due to the fact that "net income," as ascertained for Income Tax purposes, is one of the controlling factors of the computation of the Excess Profits Tax.

The instructions given in this book are based upon an experience of four years in administering Federal Tax laws, as Collector of Internal Revenue at San Francisco, Cal. That experience included the inauguration of taxation of income under the old law of 1913 and continued through the handling of thousands of individual and corporation assessments under both the law of 1913 and the Act of September 8, 1916.

Supporting the instructions and advice given in succeeding chapters are not only the regulations and practice of the Treasury Depart-

ment and the decisions of the Federal courts but also experience in dealing with actual conditions when general rules did not seem to apply and the problems that arose could be solved only by extensive official correspondence.

The taxpayer is entitled to know his rights. In this book an effort is made to tell him what they are and how to claim them.

But the taxpayer, judging by the experience of the writer, desires to meet his obligations as well as to be able to assert his rights; hence, he is told not only what he can do but also what he must do.

The Income Tax, the Excess Profits Tax, the Capital Stock Tax, the Estate Tax, the new Stamp Tax, and the several other taxes, as increased or originally imposed by the provisions of the War Revenue Act are covered in appropriate chapters, as indicated by the Table of Contents.

No instruction has been given that is not within the law. Authority can be cited on every point. The full text of official regulations has been omitted, in most cases, for the reason that, in general, the text of such regulations is little less involved and confusing than that of the laws they are intended to interpret.

JOSEPH J. SCOTT.

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CHAPTER I

THE INCOME TAX

There are now in effect two Federal Income Tax laws. One is the Act of September 8, 1916 and the other the Act of October 3, 1917. The former imposes the regular or ordinary income tax and the latter the War income tax.

The Act of October 3, 1917 is supplementary to the Act of September 8, 1916. One of its provisions is that it shall be administered according to the method by which taxes are assessed under the Act of September 8, 1916. It imposes new taxes upon individuals and corporations but in its enforcement the Government will rely upon the system inaugurated under the old law, and both new and old laws will be administered together.

In any study of the practice and policy adopted by the Government in the taxation of income the primary consideration is, therefore, an understanding of what has been done under the Act of September 8, 1916. There are a few points of difference between the two laws, but very few. The personal exemption is lowered by the Act of October 3, 1917, and the War income tax is made applicable, as far as individuals are concerned, only to those persons who are citizens or residents of the United States. More persons are subjected to the additional, or super, tax, and corporations are given certain privileges with respect to assessment of the War income tax that they do not enjoy under the assessment of the Regular or ordinary income tax.

But the differences will be explained and taken care of in the computation. The important consideration now is that the administration of the Act of September 8, 1916 must be understood if either an individual or a corporation expects to be able to take advantage of the rights allowed by law and to meet the obligations imposed.

For this reason Income Tax instructions will be based almost entirely upon practice under the Act of September 8, 1916, which is still the principal income tax law with the War income tax serving, as it

were only to bring more persons under this system of taxation and make the incomes of those who have not heretofore enjoyed exemption bear a far heavier part of the country's tax burden.

It is thought that the question of one's income tax liability (as either individual or corporation) can be ascertained by consulting the appropriate chapters, paragraphs or parts of the general income tax instructions that follow. Wherein any of such instructions do not apply to the War Income Tax is explained in the chapter on "War Income Tax."

Only one return will be required of any individual or corporation for the assessment of income tax under both laws. The computation must, therefore, take cognizance of the rates imposed by both laws. And in order that the general scheme of computation of tax liability, according to the schedules of both laws, may be understood at the outset, a condensed version of it is given and illustrated in the next succeeding chapter.

CHAPTER II

THE INCOME TAX

COMPUTATION OF INCOME TAX UNDER BOTH LAWS.

There follow condensed instructions for computing both an individual and a corporation income tax under the rates of both Income Tax laws now in effect (Act of September 8, 1916 and Act of October 3, 1917.) All of the points in this chapter are explained in more detail elsewhere in this book under appropriate headings. It is not expected that instructions relative to the treatment of net income can be followed until the meaning of "net income," according to the law and regulations and Treasury Department practice, is understood—until the taxpayer will have submitted his own particular case to the definitions, explanations and illustrations given in succeeding chapters. But in order that the taxpayer may have in mind from the outset an administration of the two income tax laws together the combined computation is outlined here. Reference should be made back to this chapter as other chapters or paragraphs are consulted.

1.—WHAT IS MEANT BY "NET INCOME."

The first thing to be understood is what is meant by "net income," as the phrase is used in the law. Many persons have their own ideas regarding that part of income which is "net," but these ideas will have to be laid aside if they do not agree with the significance of the term as used in the statute.

The net income of either an individual or a corporation is the difference between total gross income and the aggregate of certain specified deductions.

The net income of an individual is the difference between total gross income and the aggregate of deductions allowed for business expenses, taxes, interest, bad debts, losses and certain gifts to charitable, religious or educational organizations. Net income is ascertained before account is taken of any other credit allowed in the subsequent computation of tax.

The net income of a corporation is, likewise, the difference between total gross income and the aggregate of allowable deductions—such deductions, in the case of a corporation, being for ordinary and necessary business operating expenses, losses, interest, and taxes. The result at this point is net income, within the meaning of the law, before account is taken of any other credit that may be considered later in computing tax liability.

2.—THOSE WHO MUST FILE RETURNS.

Under the operation of both laws a return must be filed by

(a) Every individual who is a citizen or resident of the United States, and who, if single, has a net income of $1,000 or more, or, if married, a net income of $2,000 or more, for the Calendar year.

(b) Every alien who is not a resident of the United States and who has a net income from sources within the United States amounting to $3,000 or more for the Calendar year.

(c) Every domestic corporation, whatever the amount of its income, and even though it have none, except those of a character specifically exempted. (See "Corporations Exempt.")

(d) Every foreign corporation (subject to same exemption as to character) of its income from sources within the United States.

(e) Certain estates, as explained in appropriate paragraphs. (See index).

3.—ONE RETURN UNDER BOTH LAWS.

Only one return of income will be required by the Government from either an individual or a corporation. Upon the basis of net income shown by this one return total tax liability will be ascertained according to the rates imposed by both the old law (Act of September 8, 1916) and the new law (Act of October 3, 1917.)

4.—COMPUTATION OF INDIVIDUAL TAX.

The income tax liability of an individual who is a citizen or resident of the United States will be ascertained, in general, as follows:

(1) Determine Net Income.

Determine net income by subtracting from gross income the total of allowable deductions. By "deductions" are not meant the credits allowed for dividends, income taxed at the source, the specific exemption and the amount of Excess Profits tax assessed for the same year. By "deductions" are meant only the allowances for business expenses, taxes, interest, losses, bad debts, depreciation, depletion and gifts to certain organizations.

(2) Credit for Excess Profits Tax.

Credit net income, ascertained as just explained, with the amount of Excess Profits Tax assessed for the same year. The result, at this point, is the only basis of assessment of any income tax.

(3) Get Normal Tax Basis.

Ascertain basis of computation of the normal tax by taking credit for that part of net income represented by dividends from corporations, if any. Dividends in the hands of an individual are not subject to the normal tax.

(4) Ascertain Exemption.

Next ascertain the specific exemption allowed under both the new law and the old law—$1,000 for a single person and $2,000 for a married person or the head of a family, with an additional allowance of $200 for each dependent child, under the new law; and $3,000 for a single person and $4,000 for a married person or the head of a family, with an additional allowance of $200 for each dependent child, under the old law.

(5) Compute Normal Tax.

Next compute normal tax as follows: (a) At the new law rate of 2 per cent on the amount in excess of $1,000 and not in excess of

$3,000 in the case of a single person, and on the amount in excess of $2,000 and not in excess of $4,000 in the case of a married person or the head of a family; (b) at the rate of 4 per cent (combining the 2 per cent rate of the old law and the 2 per cent rate of the new law) on the amount in excess of $3,000 in the case of a single person and on the amount in excess of $4,000 in the case of a married person or the head of a family. Should a married person or the head of a family be entitled to the additional exemption of $200 for each dependent child, the amount of income subject to tax only at the 2 per cent rate of the new law would be the amount in excess of **($2,000 plus the additional exemption for dependent children)** and not in excess of **($4,000 plus the additional exemption for dependent children)** and tax would be imposed at the rate of 4 per cent (combined rates) only on net income in excess of **($4,000 plus the additional exemption for dependent children.)** For instance: a married person with one dependent child would be taxed at the rate of 2 per cent on net income between $2,200 and $4,200 and at the rate of 4 per cent on net income in excess of $4,200, and so on with the amount determining the tax rate increased by $200 for each dependent child.

(6) Deduct Normal Tax Withheld.

Having ascertained total normal tax liability, the individual is entitled to deduct from the amount of such liability any amount of normal tax which has been withheld at the source, and the remainder is the amount of normal tax still due the Government.

(7) Get Additional Tax Basis.

Ascertain the basis of computation of additional tax by reverting to the amount of net income before dividends were deducted. While dividends in the hands of the individual are not subject to normal tax, they are subject to additional tax. Therefore, go back to the result that was obtained when steps No. 1 and No. 2, above, had been taken.

If the amount of net income, as ascertained at the end of step No. 2, is not in excess of $5,000 no additional tax is due; if it is in excess of $5,000, additional tax liability may be ascertained by considering the ascending rate scales of both the old and the new laws. The additional tax rates of the new law alone apply if net income does not exceed $20,000 and the combined additional tax rates if net income does exceed $20,000.

The following table shows the application of each rate scale and of the two combined:

Net Income In Excess of—

	Old Law	New Law	Combined
$ 5,000 and not in excess of $ 7,500	0%	1%	1%
7,500 " " " " " 10,000	0	2	2
10,000 " " " " " 12,500	0	3	3
12,500 " " " " " 15,000	0	4	4
15,000 " " " " " 20,000	0	5	5
20,000 " " " " " 40,000	1	7	8
40,000 " " " " " 60,000	2	10	12
60,000 " " " " " 80,000	3	14	17
80,000 " " " " " 100,000	4	18	22
100,000 " " " " " 150,000	5	22	27
150,000 " " " " " 200,000	6	25	31
200,000 " " " " " 250,000	7	30	37
250,000 " " " " " 300,000	8	34	42
300,000 " " " " " 500,000	9	37	46
500,000 " " " " " 750,000	10	40	50
750,000 " " " " " 1,000,000	10	45	55
1,000,000 " " " " " 1,500,000	11	50	61
1,500,000 " " " " " 2,000,000	12	50	62
All in excess of.......... 2,000,000	13	50	63

5.—EXAMPLES OF INDIVIDUAL TAX COMPUTATION.

Note preceding instructions as applied in the following illustrations:

No. 1

John Smith is single with a net income of less than $1,000.

He is not required even to file a return.

No. 2

William Jones is married with a net income of less than $1,000.

He is not required even to file a return.

No. 3

Peter Brown is single, with no one dependent on him for support and with a net income of $1,500.

He is required to file a return and pay a tax of 2 per cent on $500.

No. 4

Arthur Burns is single, with a net income of $1,500, but his aged mother is dependent on him for support.

He is the head of a family. He should file return but in it claim exemption of $2,000 and thus have no tax to pay.

No. 5

William Tupper is married and lives with his wife and six-year-old son. His net income is $6,000.

His exemption under the new law is ($2,000 plus $200) and under the old law is ($4,000 plus $200). He is taxed at the rate of 2 per cent on the $2,000 between the new law exemption of $2,200 and the old law exemption of $4,200; and at the rate of 4 per cent on the $1,800 in excess of $4,200. But he is also subject to additional tax under the new law, which is figured at the rate of 1 per cent on the amount of $1,000, which is in excess of $5,000, but not in excess of $7,500. None of his income consists of dividends; no Excess Profits Tax has been assessed for the same year, and none of his income has been taxed at the source. In such circumstances, Tupper's total tax liability is $40 plus $72 plus $10 or $122.

No. 6

John Morrison is a widower supporting two daughters, aged 6 and 9, respectively. He is a lawyer by profession. His net income is $52,000. It is all from the practice of his profession except the amount of $800, representing a dividend on oil stock. The amount of his Excess Profits Tax for the same year figures (for the purpose of this example) $3,680.

His exemption under the new law is $2,400 and under the old law $4,400. After deducting from his net income of $52,000, the amount of his Excess Profits Tax, which is $3,680, there is a remainder of

$48,320 on which income tax must be paid. However, from such remainder should be deducted the $800 dividend in order to ascertain normal tax liability. This having been done, Morrison finds that he has $47,520 on which to compute his normal tax and he proceeds to do so as follows:

2 per cent on the amount of $2,000 between $2,400 and $4,400; and 4 per cent on all of the $47,520 above $4,400. In other words, 2 per cent of $2,000 and 4 per cent of $43,120, which results in normal tax liability of $1764.80.

Then Morrison turns to the additional tax computation. He goes back to the amount obtained when he deducted from his net income the amount of his Excess Profits Tax. On such amount, $48,320, he figures his additional tax, as follows:

On the $2,500 between $5,000 and $7,500 at 1 per cent, $25.
On the $2,500 between $7,500 and $10,000 at 2 per cent, $50.
On the $2,500 between $10,000 and $12,500 at 3 per cent, $75.
On the $2,500 between $12,500 and $15,000 at 4 per cent, $100.
On the $5,000 between $15,000 and $20,000 at 5 per cent, $250.
On the $20,000 between $20,000 and $40,000 at 8 per cent, $1,600.
On $8,320 (over $40,000 but not over $60,000) at 12 per cent, $998.40.

The above computation gives a total additional tax liability of $3098.40. The addition of this amount to the normal tax of $1,764.80 shows Morrison's total income tax liability in such circumstances to be $4,863.20.

6.—COMPUTATION OF CORPORATION TAX.

The income tax liability of a domestic corporation under both the old and the new laws will be ascertained, in general, as follows:

(1) Determine Net Income.

Determine net income by subtracting from gross income the total of allowable deductions. By "deductions" are not meant the credit allowed under the new law (but not under the old) for dividends received from another corporation and that given under both laws for the amount of Excess Profits Tax assessed for the same year. By "deductions" are meant only the allowances for actual and necessary business operating expenses, losses, depreciation, depletion, interest, and taxes.

(2) Credit for Excess Profits Tax.

Credit net income, ascertained as just explained, with the amount of Excess Profits Tax assessed for the same year. The result, at this point, is the only basis of assessment of any income tax.

(3) Compute Tax Under Old Law.

On the amount of net income shown when Steps No. 1 and No. 2, just above, have been taken, compute tax at the rate of 2 per cent—on the entire amount of net income thus shown, without any credit for dividends received from another corporation.

(4) Compute Tax Under New Law.

From the amount of net income shown when Steps No. 1 and No. 2, just above, have been taken, deduct the amount of income represented by dividends from another corporation. On the remainder compute tax at the rate of 4 per cent.

(5) Total Tax Liability.

Ascertain total tax liability for the year by adding the amount due at the old rate and the amount due at the rate imposed by the new law.

CHAPTER III

THE INCOME TAX

OLD LAW—ACT OF SEPT. 8, 1916

TAX ON INDIVIDUAL INCOME

7.—WHO ARE LIABLE.

There are three classes of individuals liable to income tax.

(a) A citizen of the United States is subject to the requirements of the law, whether or not he is a resident of the United States, and must pay tax upon his **entire net income,** less any specific exemptions and deductions allowed by the law.

(b) An alien residing in the United States is under exactly the same liability as a citizen of the country.

(c) An alien who does not reside in the United States, but with interests in this country, is subject to the law with respect to his income from all sources within the United States.

8.—NO RELIEF FROM TAX.

No person, liable under the income-tax law of the United States can claim exemption from tax by reason of payment of an income tax in another country. This ruling applies to both citizens of the United States and aliens, resident and non-resident.

It also follows that liability to the federal income tax is in no way affected by payment of an income tax imposed by any state.

9.—PARTNERS ONLY AS INDIVIDUALS.

Members of partnerships are liable for income tax only in their individual capacity. Each is required to take into account his share

of the earnings of the partnership in which he is interested in determining the question of his own individual liability. This question will be gone into fully, however, under the heading of "Partnerships."

10.—RATES OF TAX—ACT OF SEPT. 8, 1916.

The income tax, in the aggregate, consists of a tax levied at a flat rate upon **entire net income,** known as the **Normal tax,** and a tax levied on total net income, according to an ascending scale of assessment, when net income is in excess of $20,000 for the taxable year—known as the **Additional Tax.**

> Note—Often this additional tax is referred to as the "sur-tax" or "super-tax." In any event the meaning of the prefix should be obvious.

11.—NORMAL TAX RATE—ACT OF SEPT. 8, 1916.

The **Normal Tax** rate is 2 per cent.

12.—ADDITIONAL TAX RATES—ACT OF SEPT. 8, 1916.

The **Additional tax** rate is imposed according to the following scale:

1 per cent upon the amount by which total net income exceeds $20,000 and does not exceed $40,000,

2 per cent upon the amount by which total net income exceeds $40,000 and does not exceed $60,000,

3 per cent upon the amount by which total net income exceeds $60,000 and does not exceed $80,000,

4 per cent upon the amount by which total net income exceeds $80,000 and does not exceed $100,000.

5 per cent upon the amount by which total net income exceeds $100,000 and does not exceed $150,000,

6 per cent upon the amount by which total net income exceeds $150,000 and does not exceed $200,000,

7 per cent upon the amount by which total net income exceeds $200,000 and does not exceed $250,000,

8 per cent upon the amount by which total net income exceeds $250,000 and does not exceed $300,000,

9 per cent upon the amount by which total net income exceeds $300,000 and does not exceed $500,000,

10 per cent upon the amount by which total net income exceeds $500,000 and does not exceed $1,000,000,

11 per cent upon the amount by which total net income exceeds $1,000,000 and does not exceed $1,500,000,

12 per cent upon the amount by which total net income exceeds \$1,500,000 and does not exceed \$2,000,000,

13 per cent upon the amount by which total net income exceeds \$2,000,000.

CHAPTER IV

THE INCOME TAX

INCOME SUBJECT TO TAX

INDIVIDUALS

13.—INCOME FROM ALL SOURCES.

The statute makes **entire net income,** from all sources during the taxable year (which, in the case of individuals, is the calendar year) taxable with respect to the liability of citizens and resident aliens, and **entire net income** received from all sources within the United States, with respect to the liability of non-resident aliens. At the same time, however, the statute specifically exempts from tax, and even from the computation for tax, income from certain sources. But, in the main, all net income is taxable, provided it is received by the individual in sufficient quantity to exceed the exemption allowed every person. The exceptions will be taken up later.

According to the law the net income of a taxable person shall include gains, profits and income derived from

(a) salaries, wages, or compensation for personal service of whatever kind and in whatever form paid,

(b) or from professions, vocations, businesses, trade, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property,

(c) also from interest, rent, dividends, securities, or the **transaction of any business carried on for gain or profit,**

(d) or gains, or profits and income derived from any source whatever.

It is obvious from the above that Congress intended to close every possible avenue of escape from tax liability. The language of the law is so comprehensive and sweeping that no other conclusion can be drawn. Naturally, then the rulings of the Treasury Department, opinions of the Attorney-General and decisions of the United States Courts show little patience with technicalities but insist that the fundamental purpose of the law be faithfully followed by submission to taxation of all net income except that from the few sources specifically exempted .

And, yet, innume able problems have arisen and many finely drawn decisions have had to be issued. Close distinctions between income and capital transactions have had to be made.

14.—ONLY INCOME "RECEIVED."

Under the first income tax law (Act of October 3, 1913) income "accrued", as well as income "received," had to be included in a return and became subject to tax. This requirement gave rise to a great deal of confusion and inexcusable inequity. With such a provision in the statute it was impossible to administer the act fairly. But this condition was remedied by the Act of September 8, 1916 and only income "received" now need be included in a return for a particular taxable year.

15.—PROFESSIONAL FEES AND SALARIES.

It is a matter of quite common occurrence that compensation for personal service is not paid within the year during which it is earned, that is within the calendar year for which the individual is required to file a return. For instance, service rendered during the year 1916 may not have been paid for until sometime in the year 1917.

At first the Government requirement was that the individual, in filing return for the year during which the service was rendered include in the return for that year the charge for the service, even though payment had not been made. Now, however, the person in receipt of compensation for personal service, in making return of income accounts for only the amounts received during the year. A salary or fee, earned in 1917, but not paid until sometime in 1918, need not be accounted for in the return for 1917, but can be included in the return for 1918. Such is the present ruling of the Treasury Department, and it is especially applicable to the accounting difficulties of lawyers, physicians and engineers, as well as to any salaried person in receipt of a bonus, in addition to his salary, such bonus being generally determinable only after the close of the year in which earned.

16.—BONUS TAXABLE.

In some cases, of course, a bonus is clearly a gratuity; but, in general, a bonus to an employee represents additional compensation for service rendered by him and is based upon that service. When a special payment is made **as extra compensation** in pursuance of a contract express or implied, it becomes income to the employee and is subject to tax. It cannot be regarded as a gift and is not therefore in such circumstances, exempt from tax, as would be a payment clearly a gift.

17.—LIVING QUARTERS.

When an individual is furnished living quarters in addition to salary the actual rental value of such quarters is regarded as additional compensation subject to the income tax. This ruling applies to quarters for either the individual or the individual's family, or both; and it is necessary that the rental value of the quarters be ascertained with all possible accuracy. When such value has been ascertained the amount for the year should be added to the compensation for the year and this should be included in the return for the year.

In the case of Government officers this requirement is extended to cover commutation of quarters and the money equivalent of quarters furnished in kind. In this respect the ruling is that, when quarters are furnished in kind, of a less number of rooms than the number allowed by law, the money equivalent only of the number of rooms actually assigned shall be included in income for taxation. When quarters are furnished in kind of a greater number of rooms than the number allowed by law, the money equivalent only of the number of rooms allowed by law shall be returned.

18.—HEAT AND LIGHT ALLOWANCE.

Likewise, amounts received by an officer for heat and light must be returned for tax; or, if the officer occupies public quarters, the money equivalent of the heat and light furnished him, as fixed by the Government must be returned, it being the contention of the Treasury Department that by such amount is his compensation increased.

19.—MILEAGE.

The difference between the amount received as mileage and the amount of actual expense of travel must be returned for tax. The Treasury Department's ruling on this point affects, in general, only officers and employees of the Government.

20.—COMMISSIONS.

Payments received by a taxable person in the form of commissions are income subject to tax and must be returned by the salesman for the year in which received.

21.—RENEWAL PREMIUM COMMISSIONS.

Commissions on renewal premiums for insurance are taxable income for the year in which received, without respect to the date of issue of the policy. This means that commissions received on renewal premiums for insurance written prior to the incidence of the income tax must be included in the individual's return.

22.—CLERGYMEN'S FEES.

A close definition has been drawn by the Treasury Department with respect to the so-called offerings and fees received by clergymen. It is held that such offerings, received on Easter, for instance, or for funerals, masses, marriages, baptisms and the other services rendered by a clergyman, are income subject to tax. A Christmas gift to a clergyman, however, even though in the form of money, is not taxable income to him.

23.—TRUSTEE'S COMPENSATION.

A trustee of an estate must return for tax the amount he receives for his services, and **in the year he receives it.** The significance of this ruling by the Treasury Department will be appreciated when it is understood that in the ruling it is also held that if no determination was made with respect to the trustee's compensation over a period of years until the trust was terminated, the amount finally allowed must be returned **in full** for the year in which paid. The amount cannot be prorated over the period during which the trustee served. All is subject to tax for the year in which received.

24.—RENT.

Rent should be returned as income subject to tax for the year in which received. For instance, a landlord may not have received his rent for the month of December, 1916, until early in January, 1917. While the payment actually was for the use of the property in the year 1916, it was not received until the year 1917, and, therefore, should be included in the landlord's return for 1917, instead of in his return for 1916.

Board, lodging or other consideration received in lieu of cash rent is income subject to tax and its equivalent must be included in the recipient's return.

25.—DIVIDENDS—CASH AND STOCK.

Dividends are income to the recipient and must be included in the individual's return. Moreover, dividends are income, whether paid in cash or in stock.

The stock dividend must be included to the amount of the earnings or profits of the distributing corporation.

26.—DIVIDENDS—HOW TAXABLE.

While a dividend must be included by the individual in his return of gross income, the amount of it is allowed as a credit against net income for the purpose of the normal tax.

The amount of the dividend is not allowed as a credit for the purpose of the additional tax, however. It is subject to the additional tax and enters in full into the computation, according to the ascending scale of assessment.

27.—VALUE OF STOCK DIVIDEND.

A stock dividend should be returned by the shareholder receiving it at the amount it represents in the distribution made by the corporation which has paid it. In a case where a corporation has issued 1000 shares of stock of the par value of $100 and distributes 500 additional shares in payment of a dividend declared from net earnings, profits or surplus amounting to $50,000, an individual who holds ten shares of the original stock and receives five shares of the new stock as his pro rata share of the dividend, should, on account of their receipt, include the amount of $500 in his personal return.

28.—DIVIDENDS PAID IN SCRIP.

A dividend paid in scrip is returnable by the shareholder who receives it the same as a cash dividend, at the amount at which the distribution is made by the corporation paying the dividend. Payment in scrip is held to be equivalent to payment in cash, and any amount of interest subsequently paid on the scrip must be accounted for as a separate item of income.

29.—DIVIDENDS FROM FOREIGN CORPORATIONS.

When a dividend is paid by a foreign corporation which derives its entire income from the business done in the United States and pays a tax upon its net income, such dividend is to be treated in the same manner by its recipient as a dividend from a domestic corporation.

30.—BANK TAX A DIVIDEND.

When a bank pays for its stockholders a tax assessed against them, in proportion to their respective holdings of its shares, the action of the bank is regarded merely as an accommodation to the stockholders. The amount of the tax thus paid is allowed as a deduction, not in the return of income filed by the bank, but in the returns filed by the stockholders, according to the number of shares held by each. However, the individual stockholder must ,at the same time, regard the amount of tax paid upon his shares as an additional dividend and must take the amount into account in preparing his return of income.

Banks generally notify their stockholders of the amount of such payments. If such notice is not received, inquiry should be made of the bank of which the taxpayer is a stockholder.

31.—PROFITS OF LIMITED PARTNERSHIP.

The profits of those limited partnerships which make returns and pay tax in the same manner as corporations are to be treated the same as dividends by individuals receiving them. That is, they should be entered in the individual's return as dividends. Hence, they would not be subject to the normal tax in the hands of the individual but would enter into the computation for the additional tax.

32.—INTEREST.

Interest on notes, ordinary mortgages, and corporate obligations, is returnable as income subject to tax for the year in which it is received, without regard to the time of accrual. In the main the requirement of the Treasury Department is only that **interest received** be returned.

Interest on bank accounts should be included in the return for the year in which credited.

Exceptions to the general rules, referred to here, will be taken up in the discussion of other subjects as those subjects may call for consideration of the question of interest.

33.—BUSINESS AND TRADE.

The gross income of every business or trade, engaged in for gain or profit, must be included by the individual conducting it. Against this gross income may be entered, and from it deducted for the purpose of the income tax, the legitimate expenses incurred in the conduct of the business. On this point the language of the statute is clear.

Just how expenses can be deducted is explained in the consideration of "Deductions," and how the income of various kinds of business should be ascertained in accordance with the law and regulations is shown in the specialized treatment given such subjects.

34.—SALE OF PROPERTY.

In the language of the law there must be returned for tax the income derived from all **"sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property."**

It is the gain derived from transactions in property, real or personal, that is liable to tax—the gain derived from transactions that have been completed with respect to the particular property concerned, whether that property be real estate, corporate securities, or property in some other form.

The whole theory of the administration of the law is that the transaction must have been completed and the gain, if any, must have been actually realized. In other words, the property must have been disposed of by the taxpayer. [Likewise and conversely any loss sustained in such a transaction must be just as definite before it can be claimed as an offset against income, but this will be explained under the heading "Losses."]

The present law provides an entirely new method of ascertaining gain derived from the sale of property. In respect to property acquired before March 1, 1913, the incidence of the income tax, the statute provides that the **fair market price or value as of March 1, 1913, shall be taken as a starting point or basis for determining the amount of gain.**

Under the first law (Act of October 3, 1913) the original cost price (however far back) was taken as the starting point, the gain was distributed over the years the property was held and the pro-rata belonging to the period beginning March 1, 1913, was regarded as returnable income.

In the case of sale or disposition of property acquired on or after March 1, 1913 the cost is taken as the starting point and gain is ascertained by determining the difference between cost and selling price.

It is very important that these two methods of reckoning gain be kept distinct in the taxpayer's mind—that with respect to property acquired prior to March 1, 1913 and that with respect to property acquired on or after March 1, 1913. For the former there is the most

definite and specific provision in the statute itself; for the latter regulations have been made by the Treasury Department.

35.—GAIN IN REAL PROPERTY.

With respect to real estate the amendment of the law has worked important changes. When, under the old provision it was necessary in computing gain derived from a sale of real estate to go back to original cost, in all cases, and then work out the problem by proration, it was impossible to ascertain the gain belonging to the period covered by the income tax law.

For instance, an individual may have acquired 1000 acres of desert land in the year 1900 for $20 an acre. After holding the land in an unproductive state a number of years, he discovered in July 1912 that it was oil-bearing. Immediately this discovery became known, he was offered $1,000,000 for the property. But he did not sell at that time. Again, in January, 1913, he was offered $1,750,000, but he held the land until July 1916 and then sold it for $2,000,000.

Under the old system of proration the individual's income tax would have been computed about as follows:

Selling price		$2,000,000
Original Cost	$20,000	
Carrying charges (Taxes, Development, etc.)	30,000	
	$50,000	
Total cost		50,000
Gain in 16 years		$1,950,000
One year's prorata of gain		121,875
Four years' pro-rata (1913-1914-1915-1916)		487,500
Subject to tax		487,500

Under the new system the computation, in the rough, would take about the following form:

Selling price	$2,000,000
Fair market value of land as of March 1, 1913, determined by bona fide offer in January, 1913	1,750,000
Gain, subject to tax	$250,000

36.—GAIN IN PERSONAL PROPERTY.

In a similar way the gain in a sale of securities, stocks or bonds, or other form of personal property, would be computed, according to the old and the new methods.

Sometimes the new method made imperative by the Act of September 8, 1916, works in favor of the taxpayer, and at other times in favor of the Government.

In the example just given, it works in favor of the taxpayer. But change the example. Suppose, for instance, that the individual, after having received the first offer of $1,000,000 for his land, held it and sold it in July, 1916, for $2,000,000; but did not, subsequent to July, 1912, and prior to March 1, 1913, receive a second bona fide offer. In such a case it might have been necessary to take the offer of $1,000,000 in July, 1912, as indicating with the nearest possible approximation the fair market value as of March 1, 1913, in the absence of other data or the known value of adjacent lands to the contrary. And, in such circumstances the computation of gain would have shown $1,000,000 instead of $250,000.

37.—FAIR MARKET VALUE.

The fixing of **fair market price or value as of March 1, 1913,** becomes, of necessity, very difficult in many instances. The government insists upon a conclusive showing; and, likewise, the question is of such importance to the taxpayer that he should make sure of evidence which the Internal Revenue officers must accept.

With respect to real estate, in the absence of definite and bona fide offers, the selling price or market value of adjacent lands of similar character in regard to formation and productiveness is given great weight. Also assessments made by local officials, with due consideration for the particular local percentage of assessment, frequently help. And, in the case of lands passing through probate proceedings, the appraisement of such lands by the court of jurisdiction. All these factors, or any of them, can be considered. While they are not invariably accepted by the Government, they do offer valuable and generally acceptable support when it is necessary to fix an arbitrary **fair market value** as of March 1, 1913, in the absence of more specific information regarding fair market price or value as of that date.

In the matter of computing gain on the sale of personal property, such as corporate stock, acquired prior to March 1, 1913, very little difficulty is experienced with respect to stocks listed on an exchange,

or quite generally dealt in. The varying daily market prices of such issues can be readily ascertained. However, taking cognizance of the fact that in many cases there is on the one day both an opening and a closing price, the Treasury Department has held that the fair market price or value as of March 1, 1913, is the fair market price or value as of that entire day, which, in the case of variation between an opening and a closing price for the day, would mean the **average price** for the day. Even this, however, would be conditioned upon showing that the exchange quotation actually represented the fair market price or value of the stock.

In the case of securities that are not commonly or frequently dealt in, great difficulty is experienced in ascertaining fair market price or value as of March 1, 1913. The Treasury Department has not laid down a rule that can be invariably followed, and the result is that each case must be considered by itself according to the data available. Private sales of such securities, or the market price of other securities with assets of about the same value and productiveness back of them, or appraisal by a court, can be taken into consideration, even though not always controlling. Thus, at best, in many cases, the computation becomes an approximation.

38.—SALE OF SECURITIES LEFT BY DECEDENT.

In this connection an interesting point arises with respect to the sale of inherited securities by a beneficiary under a will.

If, for instance, a beneficiary under a will receives certain securities which have been appraised as of date of the decedent's death, at $100 a share, and subsequently sells them at $125 a share, he must include the increase in value in his return of income. In this connection it is essential that the taxpayer not confuse the increase of value after the securities have come into the possession of the beneficiary with the value of them at the time of the inheritance. The latter value, fixed by appraisal, in this example, at $100 a share, represents the inheritance **proper** and, as such, is not subject to income tax; but the gain, amounting to $25 a share, is a profit derived by the beneficiary from property received by inheritance and is, therefore, income which must be returned for tax by him. In other words the gain realized after the securities have come into the possession of the beneficiary is not a part of the inheritance.

39.—SECURITIES SOLD BY ESTATE.

If securities belonging to an estate are sold prior to the settlement of the estate by the executors or administrators, any gain de-

rived, if any, is computed exactly as in the case of an individual, is considered income accruing to the estate and is, therefore, subject to tax.

40.—IDENTITY OF STOCK UNCERTAIN.

When various parcels of stock of the same issue are bought and sold at different dates the rule is that wherever possible, the shares sold shall be identified by the numbers of the certificates covering them. When stock is sold, and its identity cannot be determined, the Government requires that it be charged against the stock first purchased. If the purchase occurred on or after March 1, 1913, the entire amount of difference should be returned for tax.

41.—GAIN FROM SALE OF RIGHTS.

In the enforcement of the law there have arisen many unusual cases of income to be classified and defined. One of these is that accruing to an individual who holds stock in a corporation by reason of the sale of his rights to subscribe to new stock in the corporation. Basing its ruling upon the requirement of the law that income from all sources be returned for tax, the Treasury Department has held that such income must be included in the individual's return.

42.—ACCIDENT INSURANCE.

Accident insurance gives rise to another form of income. Money received by the person insured by an accident policy on account of an accident sustained is taxable income and must be returned by the insured person. However, upon the death of the person insured, when the proceeds of the policy are paid to the individual beneficiary named in the policy, the amount paid is treated like the proceeds of a life insurance policy and is not subject to tax.

43.—DAMAGES.

And, likewise, any amount received as "damages" or compensation for injury or suffering, as the result of a suit or other proceeding, is income returnable by the person receiving the payment. However, should the amount received be in the form of reimbursement for expenses incurred by the recipient as the result of an accident, it is not subject to tax.

44.—ALIMONY AND SEPARATE MAINTENANCE.

An amount paid as alimony or for separate maintenance is taxable income to the person receiving it. The woman must include

the amount in her return if she has sufficient income, including the amount received, to make her liable to file a return. On the other hand, however, such a payment is regarded as a personal expenditure on the part of the man paying it and, as such, is not allowable as a deduction in his return.

45.—FARMER'S INCOME.

By reason of the fact that, generally speaking, he does not keep his accounts in very good order, the farmer has trouble ascertaining his income tax liability. Some simple form of accounting should be instituted by every farmer. It need not be elaborate even though his business be quite extensive. But some system is one of his most urgent needs if he is to be prepared to take advantage in full of those deductions to which the law says he is entitled.

Without a system of accounting, the farmer finds himself at the end of the year with practically nothing but the stubs of his check-book to help him meet the perplexing requirements of the income tax law. And the inevitable result is that he has lost track of innumerable expenditures that would be allowable as deductions could he state them in detail. Moreover, he is in no position to take account of the depreciation of his equipment, an item which, in many another business, is most carefully guarded. In brief, the farmer not only cannot state his gross income for the year correctly, but is also unable to claim the rights to which he is entitled.

As in the case of any other business, that of the farmer also requires individual consideration with respect to this preparation of his return of income. The Treasury Department has, however, laid down several general rules of guidance which are outlined here.

46.—INCOME WHEN PRODUCTS ARE SOLD.

All income derived from the sale or exchange of farm products should be included in the return of income for the year in which the products are actually marketed and sold. This rule covers not only that which is produced by the farmer making the return on his own place, but also any other farm products which are purchased and resold by him.

For example: The returns from hay, cut in the spring of 1917 but held by the farmer in stack or warehouse until the year 1918 for sale, belong to the farmer's income for 1918. Grain, harvested in the summer of 1917 but held for sale until the spring of 1918, con-

tributes to the farmer's income for 1918. And the same with all other products that can be held for marketing with the prospect of or hope for more favorable prices.

47.—RENTS IN CROP SHARES.

Likewise, rents received in crop-shares are to be included in the return of income for the year in which such crop-shares are reduced to money or a money equivalent.

For example: A entered into a contract with B by the terms of which B agreed to produce during the year 1915 a crop of barley on A's land and deliver to A a third of the barley in sack, as rent. B sold his two-thirds share of the barley immediately after harvest; A held his one-third share until the following spring and then sold it. B should have returned the proceeds of his share as income for the year 1915 and A the proceeds of his share as income for the year 1916, notwithstanding that the barley was all produced at the same time.

48.—COST OF CROPS.

But, while the proceeds from the sale of farm products should be included in the return of income for the year in which sold, the cost of production is allowable as a deduction for expense in the return for the year in which incurred. In other words, the cost of operating a farm during the year 1917 should be deducted as expense in the return for 1917, even though the crop produced is held for sale beyond the end of the year 1917.

49.—COST OF LIVESTOCK.

When livestock is purchased for resale by a farmer, its cost is an allowable deduction as an item of expense of operation; but when livestock is purchased for breeding or working purposes, the cost is not an allowable deduction as an expense in the farmer's return of income. In the latter case the expenditure is regarded as an investment of capital.

For example: A buys a number of calves and steers to feed and fatten for market, and the cost of the stock can be deducted by him as an item of expense. But when A buys a number of cows and mares for breeding purposes, and a work team of mules, his expenditure for them cannot be deducted in his return.

50.—LOSS OF LIVESTOCK.

Where livestock has been purchased by the farmer for any purpose and later dies from disease or injury, or is killed by order of

public authorities, the cost can be deducted as a loss by the farmer in his return of income, provided (in the case of animals purchased for marketing) the cost has not already been deducted as an item of expense, and less (in the case of animals purchased for breeding and working purposes) any amount claimed as a deduction on account of depreciation.

If a farmer, who has deducted as a loss the cost of animals killed by order of public authorities, is later reimbursed by the State, or the United States, in whole or in part, on account of stock killed, he is required to report the amount of such reimbursement as income for the year in which received. The same rule also holds true with respect to reimbursement for other property destroyed, when deduction has been claimed as a loss on account of such destruction.

51.—COST OF FARM EQUIPMENT.

The cost of farm machinery is not an allowable deduction as an item of expense. Such an expenditure is regarded as a capital investment.

However, the cost of the ordinary tools used on the farm is regarded as an item of expense and may be so deducted.

By farm machinery is meant such equipment as wagons, harvesters, mowers, tractors, and the like.

By farm tools are meant articles such as axes, shovels, simple plows and harrows and similar equipment.

52.—DEPRECIATION ON THE FARM.

The farmer may in his return of income, also claim as a deduction on account of the exhaustion, wear and tear of his property, arising out of its use in his business, a reasonable allowance for depreciation.

This applies to farm buildings (other than a dwelling on the farm occupied by the owner). It can be claimed on all buildings and structures used in connection with the business of farming—barns, sheds, fences, drying-sheds, quarters of employees and the like.

It applies also to farm machinery and to livestock purchased for breeding and working purposes.

It does not apply to livestock purchased for resale, the cost of which can be deducted as an item of expense.

53.—EXCEPTIONS TO GENERAL RULES.

In general, the rules, given above are to be followed by the farmer. However, there is a provision in the Income Tax law (Subdivision G of Section 8) which allows an individual keeping accounts

upon any basis other than that of actual receipts and disbursements to make his return upon the basis upon which his accounts are kept, provided his method reflects his income. Hence, the farmer, who keeps books, according to some approved method of accounting, which clearly show his net income for the year, may prepare his return from his books, even though his system may not follow strictly the rules outlined hereinbefore.

In the event, however, that a farmer departs from the rules and follows his own system, he must have his accounts in condition for examination by field officers of the Internal Revenue Service.

54.—FARMING FOR FUN.

The rules hereinbefore explained are applicable to farming as a business, for profit. A person who cultivates a farm for recreation or pleasure, and not according to the principles of commercial farming, is not regarded as a "farmer." The result, in his case, is generally a loss from year to year, and, if the expenses of cultivation are in excess of the receipts from the farm, the entire venture may be ignored in the preparation of his return of income. The receipts need not be included in his return and the expenses of cultivation, being regarded as personal expenditures for pleasure, cannot be deducted from income derived from other sources.

55.—INCOME DERIVED FROM GIFT.

While the law provides that "the value of property acquired by gift, bequest, devise, or descent," is not income subject to tax, it must be clearly understood that any gains or profits derived from such property, after the property has been thus acquired, are subject to tax. For example: A inherits industrial bonds valued at $100,000 paying interest at the rate of 6 per cent per annum. The value of the bonds is not taxable income to A but the interest received by A after his acquisition of the bonds must be returned by him.

56.—PENSIONS.

Pensions paid by the United States Government are subject to the income tax.

Likewise pensions paid by private corporations to retired employees are subject to tax if the person receiving them has sufficient income, including the amount thus received, to make him liable.

57.—INCOME FROM PARTNERSHIP.

While a partnership is not subject to income tax, each individual partner is required to include in his personal return as a part of his

gross income his share of the net earnings of the partnership. However, the members of a partnership which deals in State, municipal or other similar bonds, the interest on which is not subject to income tax, can exclude from their distributive interests in the partnership's earnings their proportionate shares of the interest received by the partnership on all such bonds.

58.—INCOME FROM EXPORT BUSINESS.

It has now been determined that income derived from an export business is clearly subject to tax. Legal attack was made on the requirement that income from such business be returned for taxation, the contention being that such an interpretation of the law was unconstitutional on the ground that to tax the income from export business is to tax the articles exported. In the case of Wm. E. Peck & Co. vs. John Z. Lowe Jr., collector (234 Fed. 125) decision is given in favor of the Government, and the income from such business is subject to tax.

59.—ROYALTIES, PATENTS, COPYRIGHTS.

A payment in the form of a royalty on a patent is returnable by its recipient.

A payment in absolute purchase of a patent right, as a result of which title to the patent passes, is returnable by the recipient as income to the amount by which such payment exceeds the aggregate amount expended in perfecting the invention and obtaining the patent.

Quite similarly would be treated income derived in the form of royalties on publications or from the disposition of a copyright.

The consideration of royalties from mines and oil and gas wells will be taken up in connection with the treatment of income from natural deposits in the earth.

60.—MATURED BUILDING AND LOAN SHARES.

When a certificate in a Building and Loan Association is matured and payment on account of such maturity is made by the association to the holder of the certificate, if the amount paid is in excess of the aggregate of the deposits made by the holder of the certificate to bring the certificate to maturity, the amount of such excess should be returned by the certificate holder for the year during which the certificate is matured.

61.—TAXABLE INSURANCE INCOME.

While the law exempts from tax the proceeds of life insurance policies paid to individual beneficiaries upon the death of the insured,

and the amount received by the insured, as a return of premiums paid by him under a life insurance endowment, or annuity contract, either during the term or at the maturity of the term mentioned in the contract or upon the surrender of the contract, still there are certain gains from insurance policies or contracts that are regarded as taxable income.

When the amount paid to the insured under a life insurance, endowment, or annuity contract, either upon the maturity or surrender of the contract, exceeds the sum paid by the insured pursuant to the contract, the amount of the excess is held to be income subject to tax and should be returned by its recipient.

Also dividends received by the insured from a paid-up policy are held taxable income to the insured and must be treated the same as dividends from a corporation's earnings in his individual return of income.

CHAPTER V

THE INCOME TAX

INCOME EXEMPT FROM TAX

Under the specific mandate of the statute certain income is exempt from the provisions of the law. Such income is clearly defined and is exempt **not only from tax but also from any other provision of the law.** In other words, with respect to income which comes within the exemptions named in the statute, the recipient has no duty to perform to the Government. He is not even required to report any such income and no amount, thus received, need be considered by him in determining his liability to make a return.

62.—DEFINITION OF EXEMPT INCOME.

Section 4 of the Income Tax Law, Act of Sept. 8, 1916, reads as follows:

> The following income shall be exempt from the provisions of this title:
>
> The proceeds of life insurance policies paid to individual beneficiaries upon the death of the insured;
>
> The amount received by the insured, as a return of premium or premiums paid by him under life insurance, endowment or annuity contracts, either during the term or at the maturity of the term mentioned in the contract or upon surrender of the contract;
>
> The value of property acquired by gift, bequest, devise or descent (but the income from such property shall be included as income);
>
> Interest upon the obligations of a State or any political subdivision thereof or upon the obligations of the United States (but, in the case of obligations of the United States

issued after September 1, 1917, only if and to the extent provided in connection with the issue thereof) or its possessions or securities issued under the provisions of the Federal Farm Loan Act of July 17, 1916;

The compensation of the present President of the United States during the term for which he has been elected and the judges of the supreme and inferior courts of the United States now in office,

And the compensation of all officers and employees of a State, or any political subdivision thereof, except when such compensation is paid by the United States Government.

63.—PROCEEDS OF INSURANCE POLICIES.

In making up his return of income the taxpayer can ignore income derived from insurance policies or contracts as such income comes within the meaning of the law. He should not include any amount thus received in his statement of gross income. He can be guided by the following general definitions of exempt insurance income:

(a) Proceeds of life insurance policies paid upon the death of the person insured to an individual beneficiary.

(b) Amount paid under a life insurance, endowment, or annuity contract to the person making the contract (the insured) either upon the maturity or surrender of the contract; provided, such payment does not exceed the sum paid on the contract by the insured. When there is such an excess, the amount of it becomes taxable income in the hands of its recipient, the insured.

(c) Dividends paid on life insurance policies **that have not matured,** whether such dividends are drawn in cash by the insured or applied to the reduction of the annual premium due. (Dividends from paid-up policies are, however, considered taxable income.)

(d) Amount paid on life insurance policy to beneficiary in annuities or installments.

64.—GIFTS, BEQUEST, ETC.

The law provides that the **value** of property acquired by gift, bequest, devise, or descent does not represent taxable income to the recipient, but it does definitely provide that any income from such property, after the property has come into the hands of the recipient, is taxable and must be returned by him.

Distinction must therefore, be drawn between the **value** of the property at the time it comes into the possession of the person who benefits by the gift or bequest, and the subsequent **income** from the property.

A bonus received by an employee, as additional compensation for services rendered, is not a gift, if paid by the employer pursuant to a contract, express or implied, or pursuant to a fixed policy or practice. In such circumstances, the amount of the bonus is regarded as a part of the wage of the employee. Payment of the bonus in a case of this kind, however, would have to be conditioned upon the services rendered by the employee and not upon the earnings of the employer.

Where the salary of an employee is paid for a limited period after his death to his widow, or other dependents, in recognition of the services rendered by the deceased employee, no services being rendered by the widow or other dependents, the payment is regarded as a gift and is not subject to tax.

65.—INTEREST ON U. S. AND STATE BONDS.

Income in the form of interest on bonds or obligations of the following general classifications is exempt and need not be included in a return:

(a) Bonds or obligations of the United States or its possessions (except as to the limitation with respect to obligations issued after September 1, 1917, as hereinafter explained).

(b) Federal Farm Loan bonds, issued under authority of the Federal Farm Loan Act of July 17, 1916.

(c) Bonds of any State.

(d) Bonds of any political subdivision of a State.

[Note—important:

The exception noted above in (a), with respect to interest on bonds or obligations of the United States issued after September 1, 1917, has reference to a provision in the Act of September 24, 1917 to the effect that if the aggregate principal of the bonds and certificates issued by its authority and owned by one individual, partnership, corporation or association, does not exceed $5,000, the interest on them is exempt from income tax. If the aggregate principal of a single holding does exceed $5,000, then the interest on the principal in excess of $5,000 is subject to the graduated additional income tax. But only an individual is liable to the graduated additional income tax; hence only an individual is concerned with the amount of investment in such

securities when income tax liability with respect to the interest is incurred. The Liberty Loan Bonds of the Second Series were issued subject to this provision. The Liberty Loan Bonds of the First Series are not subject to the provision, they having been issued prior to September 1, 1917. All interest on the bonds of the First Series is exempt from income tax.]

66.—WHAT "POLITICAL SUBDIVISION" COVERS.

Referring to sub-paragraph (d) of the preceding general paragraph, the full scope of the meaning of the phrase "political subdivision of a state" should be understood. The Treasury Department has ruled, upon the advice of the Attorney-General of the United States, that it comprehends the bonds issued by

(a) Municipalities
(b) Counties
(c) School Districts
(d) Irrigation Districts
(e) Reclamation Districts
(f) Levee Districts
(g) Street Assessment Districts.

Interest on all such bonds is not to be considered for income-tax purposes.

However, a mortgage assumed by a municipality in the purchase of a public utility, at the time of purchase subject to mortgage, does not become an obligation of the municipality within the meaning of the exempting provisions of the law with respect to interest.

67.—STATE, COUNTY, MUNICIPAL EMPLOYEES.

The exemption with respect to the compensation of officers and employees of a State, or political subdivison of a State is applicable to the salaries not only of all elected and appointed officers and employees of a State, county or municipality but also to the salaries of public-school teachers, members of the faculty and employees of a State University or other institution of learning, managers, superintendents and employees of all State, county and municipal institutions, and even special compensation paid by a State, or any political subdivision of a State, for professional services, whether such payment be denominated salary or special fee.

However, a payment made by a State or political subdivision of a State to a contractor engaged in the construction of a public work pursuant to the terms of a contract is not exempt.

CHAPTER VI

THE INCOME TAX

DEDUCTIONS ALLOWED INDIVIDUALS

[The deductions explained in this chapter are those allowed citizens or residents. For deductions allowed non-resident aliens read chapter on "Non-Resident Aliens."]

Unless the individual, on the one hand, knows his rights of deduction and, on the other, understands the technical limitations established by the Treasury Department, he is sure to be in trouble all the time, both before and after the filing of his return. He may, in the first place, overestimate his rights, upon the meager information available to him, and decide, without consulting authority, not to file a return. Then comes a day of reckoning. The field officers of the Internal Revenue Service, following leads from their innumerable sources of information, check him up and call for an explanation.

Or, the individual may, in an excess of caution, neglect to charge against his gross income for the year deductions to which he is legitimately entitled. He may be wary of insisting upon the credits the law allows him lest he make a mistake. Government officers do not, as a rule, call him in and advise him that he has overstated his taxable income. In haphazard fashion he makes up his return and submits thousands of dollars to assessment that the law does not contemplate taxing. He pays dearly for his failure to assert his rights.

It, therefore, behooves every individual to look closely into his rights of deduction before filing his return. In this chapter such rights of deduction will be outlined. It will be necessary, however, to supplement the information given in this chapter by consulting that given elsewhere in the book under headings applicable to the questions involved.

68.—EXPENSE OF BUSINESS.

The deduction for expense is limited to the expenditures in the conduct of the business of the individual during the year for which the return is made. There may be one business, or more than one; if the necessary expense of operation for the year has actually been paid, the amount may be deducted. This expense may comprise many items, as will hereinafter be explained, but the first essential is that it be strictly the year's operating expenditure in connection with the individual's business.

69.—NO PERSONAL EXPENSE.

No amount representing the personal, living or family expenses of the taxpayer can be deducted in his return. On this point the Government is very strict and a great deal of the trouble in which taxpayers have become involved has been due to their failure to obey the requirement, generally through lack of understanding of some of the Government's finely drawn distinctions between business and personal expense. However, with respect to the general exclusion of personal, living or family expenses the language of the law is clear, even though individuals may differ regarding the distinctions imposed by regulations and decisions.

70.—NO PARTNERSHIP EXPENSE.

A business expense incurred by a partnership is not allowable as a deduction in the return of an individual partner for the reason that such partner is required in his statement of **gross income** from all sources to include only his share of the **net earnings** of the partnership. The business expenses of the partnership have, therefore, been taken care of in determining the partnership's net earnings, and are not a proper charge against the gross income of the individual partner.

71.—NO COST OF MERCHANDISE.

Cost of merchandise, when considered in connection with a mercantile business, should not be deducted as an item of expense. Gross income from a mercantile business—the amount reported in the return—is ascertained by opening and closing inventories, hence cost of merchandise is accounted for in ascertaining the amount of gross income from the mercantile business and would not, therefore, be properly chargeable again in the individual's return.

72.—NO PERMANENT IMPROVEMENT.

And a question that has given rise to no end of controversy is that relative to expenditures for improvements and betterments. The

law and Treasury Department regulations do not allow such an expenditure as a deduction from gross income. An expense of this nature is regarded as a capital investment. In many instances, however, it has been difficult to draw the line between business expense and expenditure for a permanent improvement or betterment. So many and varied problems have arisen that each case must be considered upon its own merits. Always, however, the theory should be followed that an expense tending to increase the value of a property goes into an improvement or betterment, and is not deductible. Such would be the cost of new buildings, or of additions to old buildings, and the remodeling of old buildings and installation of modern equipment and conveniences. In this last respect, however, the cost of repairing and rennovating a business building, as such expenditure is necessary to keep the building a producing property, is an allowable deduction as a business expense.

Other paragraphs on special subjects should be consulted for information as to the treatment of expenses in connection with them.

73.—EXPENSES ON RENTED PROPERTY.

In his return the individual is required to report his gross receipts from rents. Deduction may be claimed on account of any expense incurred in the maintenance of the property, or its use, for rental purposes, including amounts paid for repairs, insurance, fuel, light and water, janitor and elevator service. The deduction for such expense of maintenance must, however, be claimed against total gross income **from all sources.** Experience has shown that many landlords have first deducted from gross rental receipts the expense of maintenance and have then included in their returns the net income from rent. This is not allowed under the regulations of the Treasury Department.

74.—ASSESSMENTS ON STOCK.

Assessments paid by an individual on stock do not constitute a deductible expense any more than does an original investment in stock. Such payments are regarded as strictly capital transactions—as additional investments of capital in the stock of the corporation.

In New York City there arose an interesting case in this connection. A corporation, whose stock had been fully paid and was non-assessable, found a deficit at the close of the year, which the stockholders made good by agreeing to the payment of voluntary assessments. The Treasury Department held, by letter, that the payment

of such "voluntary assessment" by the stockholders was, to all intents and purposes, additional payment for the stock of the corporation and, therefore, a capital expenditure. The stockholder could not deduct the amount paid in rendering his individual return.

It follows, of course, (as will be explained in another paragraph) that when such a payment is not allowable as a deduction to the stockholder, it is not income to the corporation receiving it.

75.—PREMIUM ON BOND.

A premium paid on a fidelity bond by an employee (when he is required to furnish bond,) or on the faithful performance, labor and material or other surety bonds given by contractors or others in connection with business transactions, is a business expense allowable as a deduction. Under this rule would come the premiums on the bonds required by the Government from distillers, wine-makers, liquor dealers, brewers and cigar and tobacco manufacturers, covering both the manufacture and movement of their products.

76.—COMMISSIONS AND FEES.

Commissions and fees, required to be paid in the transaction of business are items of business expense allowable as deductions; examples of such items being commissions paid real estate agents and salesmen and fees paid for professional services rendered in connection with the business of the taxpayer.

77.—INSURANCE PREMIUMS.

The cost of insurance on property which is not occupied by the owner as a dwelling is allowable as a deduction. The rule is that the cost of all business insurance is a legitimate business expense and the amount of the premium paid during the year may be deducted. This may be the premium on fire insurance, burglary or general liability insurance, workmen's compensation insurance, or other form of insurance required in connection with the taxpayer's business. It covers also insurance on merchandise, stock, crops and business equipment of any kind, as well as insurance on buildings.

Premiums paid on life insurance policies by the insured can not be deducted in his return. They are regarded as personal expenses.

78.—FARMER'S DEDUCTIONS.

A farmer, of course, is entitled to every deduction, as business expense, allowable in any other kind of business, provided such expense be necessary in the operation of his farm. However, there are

certain additional items of expense peculiar to the business of farming that may be mentioned. For example, the farmer may deduct the cost of

(a) Stock and crops bought for resale.
(b) Seed.
(c) Farming tools (but not machinery.)
(d) Feed for stock.
(e) Fertilizer.
(f) Tree or vine spray.
(g) Crop insurance.

79.—ALIMONY.

Any amount paid as alimony is not allowable as a deduction in the return of the person paying it, the expenditure being regarded as a personal expense. However, the person receiving alimony must account for it as taxable income.

Likewise, many expenditures, while personal expenses and therefore not allowable deductions to those paying the money, must be returned as taxable income by recipients of them.

80.—INTEREST PAID.

In the language of the law the individual (citizen or resident of the United States) can deduct from gross income for the taxable year

> All interest paid within the year on his indebtedness except indebtedness incurred for the purchase of obligations or securities the interest upon which is exempt from taxation as income under this title.

The exception noted in the paragraph above is an amendment carried by the War Revenue Act and refers, of course, to indebtedness incurred for the purpose of purchasing securities such as United States, State, County, Municipal, School, Street Improvement, Irrigation District, Farm Loan, and other bonds of a public character, the interest upon which is not subject to income tax.

Any amount of interest deducted must have been paid on the personal indebtedness of the individual during the year for which the return is made.

81.—TAXES PAID.

In the Income Tax law, as amended by the War Revenue Act, the provision for deduction on account of taxes reads as follows:

> Taxes paid within the year imposed by the authority of

the United States **(except income and excess profits taxes)** or of its Territories, or possessions; or any foreign country, or by the authority of any State, county, school district, or municipality, or other taxing subdivision of any State, not including those assessed against local benefits.

The amendment carried by the War Revenue Act is the exception of Federal income and excess profits taxes. The amount of these taxes paid during the year for which return is filed cannot be deducted from gross income in filing a return. However, in assessing income tax, there will be allowed a credit against the net income shown in the return of the excess profits tax assessed for the same tax year. The limitation written into the law does not refer to the income tax imposed by any State. Such a tax is obviously still allowable as a deduction in the return for the year in which it has actually been paid.

82.—TAXES AGAINST LOCAL BENEFITS.

The other limitation in the law with respect to deduction on account of taxes paid is that covering **"taxes assessed against local benefits."**

By such taxes are meant payments made pursuant to assessment levied by a special district—an assessment confined in its application to property within a certain limited area and resulting in a local betterment of that property. A case in point is the cost of street improvement or sidewalk construction within a specified district of a city. The district covered by the assessment may be small in relation to the size of the city (such is generally the case with respect to a street or sidewalk assessment), or it may be more extensive and affect property within a much greater area as in the case of so well known an improvement as the Twin Peaks Tunnel in San Francisco. A tax of this kind is not allowable as a deduction.

And the Treasury Department has ruled that the limitation has reference also to an irrigation, reclamation, or drainage district assessment where local improvement is again the purpose of the expenditure. The municipality seems to be the smallest taxing unit acceptable to the Government as capable of imposing a tax sufficiently general in application to be allowable as a deduction.

83.—STATE INHERITANCE TAX.

A collateral inheritance tax, levied under the laws of a State and made a charge against the corpus of the estate, has been held by the Treasury Department to constitute such an item of expenditure as cannot be allowed as a deduction in computing the income tax liability of either the beneficiary of the inheritance or the estate.

84.—TAXES PAID BY A BANK.

A great deal of confusion has arisen over the payment to the State directly by a bank of taxes assessed against the stockholders of the bank in proportion to the number of shares of stock held by each. Such a tax, the Treasury Department holds, is in reality paid by the bank in behalf of its stockholders. It becomes, therefore, a proper deduction for each stockholder to claim, according to his interest; but cannot be claimed as a deduction by the bank. As hereinbefore explained, however, the stockholder must at the same time account for the amount of the tax upon his shares as an additional dividend from those shares.

85.—CUSTOMS DUTIES.

Import duties are also deductible taxes in the return of an individual required to pay them. In the case of a person engaged in the importation of merchandise as a business the amount of customs charges may be added to the cost of the merchandise, if preferable, or may be treated as a payment of tax. In any case it is allowable as a deduction.

86.—TAXES MUST BE PAID.

To be allowable as a deduction, however, the tax must actually have been paid within the year for which the return of income is rendered. Where an annual local assessment becomes due in two installments, in different calendar years, it follows that the amount claimed as a deduction by an individual in his return for the first calendar year is frequently the sum of the second installment of the local assessment for the year before (paid in the year for which the return is rendered) and the first installment of the local assessment for the year for which the return is rendered.

87.—FOREIGN TAXES.

There is no limitation with respect to a tax paid to a foreign government. The entire amount of the tax paid within the year may be deducted. This also includes any **foreign income tax** even though the United States income tax is not allowable as a deduction.

However, a foreign tax payment is deductible only in the return of a citizen or resident of the United States. It cannot be charged against his income from sources within the United States by a non-resident alien.

88.—LICENSE AND STAMP TAXES.

Local license taxes, State excise or franchise taxes and the Federal license, stamp and occupational taxes are all proper deductions. In this connection may be mentioned such expenditures as those made by various kinds of business for municipal or county licenses, those payments to the State for licenses and franchises and those payments to the Government either in the purchase of Internal Revenue stamps or for the privilege of conducting business. The exception with respect to the Federal Income and Excess Profits taxes should, however, be kept in mind.

89.—LOSSES DEDUCTIBLE.

The allowance for losses—and the Treasury Department's strict ruling on every point that has arisen—has caused more confusion and brought more controversy between government officials and taxpayers than any other feature of the Income Tax law. Properly this allowance for losses may be divided into three distinct provisions as follows:

(a) Losses arising from fires, storms, or shipwreck, or other casualty, and from theft, when such losses are not compensated for by insurance or otherwise.

(b) Losses sustained in the business or trade of the individual who makes the return.

(c) Losses sustained in transactions that have been entered into for profit but are not connected directly with the business or trade of the individual who makes the return.

Before attention is given to each of the above kinds of losses, certain general restrictions imposed by the Government in its interpretation of the law should be emphasized.

90.—LOSS MUST BE ABSOLUTE.

A loss to be allowable as a charge against gross income must have been actually sustained and ascertained during the year for which the return is filed. The Government insists upon an exact definition of the words **"actually sustained during the year,"** appearing in the law. The loss must be absolute and must result from a transaction which has been completed. It must be the outcome of dealing in property, real or personal, which has been closed and does not offer further opportunity for either additional loss or recovery from loss. Where an investment has been continued by the taxpayer and his loss is represented only by a decrease in the value of the

property he holds there has not been sustained a loss which can be allowed as a deduction, according to the Treasury Department's ruling. In other words, the uncertainty of fluctuation in value cannot be considered; the transaction must have been closed and the loss must have been thus determined during the year for which the return is made.

91.—LOSS FROM CASUALTY.

To revert to the classification of losses under three general definitions, consider, first, the loss from fire, storm, shipwreck, or other casualty, or from theft, when such loss is not compensated for by insurance, or otherwise.

If the insurance is insufficient, the loss in excess of the amount of insurance received may be claimed as a deduction. Cost should be taken as the basis of computation in such a case. If the insurance received is full compensation for the property destroyed, or lost, no deduction on account of the casualty can be claimed, and no account need be rendered of the receipt of the insurance in making a return of income.

92.—LOSS IN BUSINESS OR TRADE.

But with respect to a loss sustained in business or trade the Treasury Department has applied the strictest kind of interpretation to the language of the law.

First, there is the loss incurred in the taxpayer's business or trade during the year. Then, there is the loss incurred in transactions entered into for profit by the taxpayer but not connected with his business or trade. The experience of the writer in administering the Income Tax law is that the public has never become reconciled to the Treasury Department's interpretation of the Act in this respect. In a way, the decisions of the department are conflicting, as will be pointed out; at least they are sufficiently indefinite to leave doubt in the mind of the taxpayer.

A loss incurred in the taxpayer's business or trade is deductible in full. A loss incurred in transactions entered into for profit by the taxpayer, but not connected with his business or trade, is deductible only to an amount not exceeding profits from other transactions of a similar kind during the year.

93.—WHAT IS A MAN'S BUSINESS?

And so it has become necessary for the Treasury Department to attempt to say what is an individual's business or trade and when a transaction is not connected with that business or trade.

Says the Department in Treasury Decision 2090:

The term "in trade," as used in the law is held to mean the trade or trades in which the person making the return is engaged; that is, in which he has invested money otherwise than for the purpose of being employed in isolated transactions, and to which he devotes at least a part of his time and attention. A person may engage in more than one trade and deduct losses in all of them, provided, that in each trade the above requirements are met. As to losses on stocks, grain, cotton, etc., if these are incurred by a person engaged in trade to which the buying or selling of stocks, etc., are incident as a part of the business, as by a member of a stock, grain, or cotton exchange, such losses may be deducted. A person can be engaged in more than one business, but it must be clearly shown in such cases that he is actually a dealer, or trader, or manufacturer, or whatever the occupation may be, and is actually engaged in one or more lines of recognized businesses.

The Government insists that the above requirements be met before the full amount of a loss may be allowed as a deduction. The result is controversy without end. Before the Income Tax law was amended and re-enacted by the Act of September 8, 1916, no amount of loss sustained in a transaction not connected with the business or trade of the individual was deductible, according to the ruling in Treasury Decision 2090, and before that in Treasury Decision 2005. With the law in its present form, and the ruling still the same, only so much of such loss may be deducted as the amount of the loss does not exceed a profit from a similar transaction. If there has been no profit during the year, no loss, however great, may be deducted.

The condition of confusion is one that requires that each taxpayer do his best to comply with the Treasury ruling. Each case, each loss, must be considered on its own merits.

The difficulty comes, however, from the application of the Treasury ruling. The Department has plainly stated that an individual may be engaged in more than one trade or business; and yet in practice it has repeatedly denied individuals this privilege in connection with allowance for losses.

A case in point is refusal to allow a banker and investor to deduct in full his losses in stocks and the promotion of manufacturing ventures, when, as a matter of fact, he gives as much time to his stock investments and industrial promotions as to his banking activities. He happens, however, to have the title of bank president.

Another case is the disallowance of the full amount of losses claimed by an investor in connection with real estate investments, the Treasury Department holding that only a person whose business is that of a real estate dealer may deduct in full his losses from real estate transactions.

The Treasury Department has also taken the position in its instructions to field investigating officers that only a person whose business is that of a licensed and recognized broker, and who buys and sells securities for others as well as for himself, has a right to deduct the full amount of any loss sustained in handling stocks and bonds.

These references to the position of the Treasury Department are made merely in illustration. Obviously, under the original Income Tax Law, the Act of October 3, 1913, the Treasury Department sought merely by regulation to prevent deduction of speculative losses. Then in the Act of September 8, 1916, Congress, in part, acceded to the stand taken by the Treasury, and wrote in the fifth paragraph of subdivision (a) of Section 5 (note text of law). This amendment provides for allowance of a speculative loss only in a year when the taxpayer has enjoyed a speculative profit, and, even then, never to an amount in excess of the profit.

An example: A lawyer invests in two issues of stock and sells both during the year. In one transaction he loses $10,000 but in the other makes a profit of $5,000. He can claim deduction for a loss of only $5,000, and at the same time must include his profit of $5,000, in the latter transaction, in his statement of gross income.

Another example: The lawyer loses in both transactions, selling one lot of stock for $10,000 less than cost and the other for $5,000 less. He has made no profit in a similar transaction during the year, and so cannot claim as a deduction any part of his total loss of $15,000.

94.—TAXPAYER'S COURSE.

It is suggested that the individual adopt the following course:

1.—Deduct in full every business or trade loss sustained during the year if transactions of the general character of that in connection with which the losses have been incurred have engaged a part of his time and attention in the ordinary course of affairs from year to year and are not to him merely isolated and speculative ventures.

2.—In connection with the explanation of the loss deduction which he is required to make, attach a rider to his return calling attention to the fact that he is engaged in

> **more than one trade or business, and furnishing evidence of the fact.**
>
> **3.—Fall back upon the provisions of the fifth paragraph of subdivision (a) of Section 5 of the law only in the case of a transaction strictly speculative and isolated, with respect to its character, from the course of his ordinary business affairs.**

The individual will be within his rights if he follows the suggestion just made. He knows whether he is engaged in one business, or more than one business, and it is his right to make his claim for deduction on account of losses accordingly. By doing so he risks no penalty but may save hundreds (or possibly thousands) of dollars in taxes that he does not legitimately owe and should not be assessed.

95.—HOW TO ASCERTAIN LOSS.

In the event a loss is deductible it must be ascertained according to one of two general methods.

> 1.—When sustained from the sale or other disposition of property, real, personal or mixed, acquired before March 1, 1913, the amount of loss must be determined upon the basis of the fair market price or value of the property as of March 1, 1913.
>
> 2.—When sustained from the sale or other disposition of property acquired on or subsequent to March 1, 1913, the amount of loss must be determined upon the basis of the cost of the property.

In this connection it is suggested that the reader note the explanation given with respect to method of ascertaining gain from the sale or disposition of property, real or personal.

96.—VALUE AS OF MARCH 1, 1913.

The fair market price or value of real property as of March 1, 1913 can be ascertained by considering any bona fide offer made immediately prior to that date, or the selling price at about that time of similar property, or in some other way suggested in the paragraph on **"Gain from Real Property."** Sometimes the individual must fall back upon such bases as local assessment and court appraisement for a working foundation. The method must be varied to fit each individual case; it is impossible to lay down a general rule.

And in some respects so it is in regard to the fair market price or value of personal property, particularly securities, as of March 1,

1913. There is, however, to be considered the fact that in the case of many such securities as stocks and bonds there is available record of the price at which they were selling on the market on March 1, 1913; hence in any such case the determination of a basis of loss computation is comparatively simple.

97.—COST ON OR AFTER MARCH 1, 1913.

The cost of property acquired on or after March 1, 1913 (as a basis of ascertaining loss or gain) is held by the Treasury Department to be the actual price paid for it, plus any expense incident to purchase and sale, and the cost of improvement, if any. Special assessments, which have added to the value of the property and have not been allowed as deductions on account of taxes, also become a part of the cost of the property, in the case of real estate. Such assessments are those for street and sidewalk improvement, local sewerage, and the construction of irrigation and reclamation works.

98.—BAD DEBTS.

Deduction for bad debts is allowed only when the debt due the taxpayer has been actually ascertained to be worthless and has been charged off within the year for which the return is made.

It is not sufficient that the taxpayer merely regard a debt as worthless. He must have made some effort to collect and must have then charged off the amount due him as an absolute loss in his own system of accounting. The insistence of the ruling is that there be no guessing as to the worthlessness of the debt. The fact of loss must be established to make the amount due an allowable charge against gross income.

99.—DEPRECIATION DUE TO EXHAUSTION, WEAR AND TEAR.

The Federal Income Tax law provides for the deduction of a **"reasonable allowance"** for the exhaustion, wear and tear of physical property used in the business of the taxpayer. Such **"reasonable allowance"** may be claimed in a return of income, provided the fact that it is "reasonable," within the meaning of the Treasury Department regulations, can be established.

However, for the reason that the subject is one of such great importance and for the further reason that both **individuals and corporations** must follow the same rules, it has been deemed advisable to dis-

cuss the question fully with detailed illustrations, in a separate chapter under the heading, **"Depreciation of Physical Property."** The reader is, therefore, referred to the special chapter on the subject.

100.—DEPLETION OF OIL, GAS AND ORE DEPOSITS.

Also, the taxpayer is allowed to deduct a **"reasonable allowance"** for reduction in flow of oil and gas from wells, and for depletion of ore deposits in mines.

But, as in the case of depreciation of physical property, this subject is one with which **both individuals and corporations** are concerned and can be done justice only in a separate chapter where it can be gone into in full detail. And so the reader is referred to such special chapter under the heading, **"Depletion of Natural Deposits."**

101.—GIFTS TO CHARITIES, ETC.

An individual is also allowed as a deduction contributions or gifts made during the year covered by his return to charitable and other organizations of certain classes, but the deduction on this account can not be excess of 15 per cent of what his net income would be if this particular deduction were not allowed. In order for such a contribution or gift to be allowable as a deduction, the organization to which it is made must have been formed and be operated exclusively for religious, charitable, scientific, or educational purposes, or it may be a society for the prevention of cruelty to children or animals, provided no part of its net income inures to the benefit of any private individual.

CHAPTER VII

THE INCOME TAX

CREDITS IN COMPUTATION OF INDIVIDUAL TAX.

(The credits referred to in this chapter are those allowed citizens or residents of the United States.)

102.—CREDITS ALLOWED.

Even after the individual has stated in full his gross income (excluding, of course, income exempt from tax) and has claimed the deduction to which he is entitled, there are certain credits he is allowed in the computation to determine his tax liability.

103.—CREDIT FOR EXCESS PROFITS TAX.

The law provides that in assessing income tax the net income shown by a return shall be credited with the amount of any excess profits tax assessed for the same tax year. The amount of the excess profits tax is not allowed as a part of the general deduction for taxes in ascertaining net income (net income being gross income less deductions), but when net income has been ascertained it can be credited with the amount of excess profits tax assessed for the same tax year. Thus the amount of net income shown by the return less the excess profits tax, if any, assessed for the same tax year is the basis of income tax assessment. There are, however, certain other credits to be considered in the computation of **normal tax liability.** They are explained in the paragraphs immediately following.

104.—CREDIT FOR DIVIDENDS.

The law provides that "for the purpose of the normal tax only, the income embraced in a personal return shall be credited with the

amount received as dividends upon the stock or from the net earnings of any corporation, joint-stock company or association, or insurance company, which is taxable upon its net income."

The amount received as dividends must be stated as a part of gross income but after **net income** has been ascertained by subtracting the total amount of deductions from gross income and after proper credit has been taken for excess profits tax, if any, the amount of dividends may be deducted in the computation of **normal tax** liability.

However, as noted above, (in the case of a net income running into figures to make it subject to the additional tax) the determination of **additional tax** liability is entirely another consideration, and into such computation the amount of dividends must enter. On this latter point the law reads as follows:

> "For the purpose of the additional tax there shall be included as income the income derived from dividends on the capital stock or from the net earnings of any corporation, joint-stock company or association, or insurance company."

105.—SPECIFIC EXEMPTION.

Credit is also allowed for what is known as the **"specific exemption,"** with respect to the net income of every individual (citizen or resident).

This **specific exemption** under the old law (Act of Sept. 8, 1916) is as follows:

(a) A single person who is not the **head of a family** is allowed $3000.

(b) A single person who is the **head of a family** is allowed $4000 and an additional $200 for each dependent child.

(c) A married man living with his wife, or a married woman living with her husband, is allowed $4000 and an additional $200 for each dependent child.

106.—HEAD OF FAMILY.

The Treasury Department has defined **"the head of a family"** as follows:

> **"A person who actually supports and maintains one or more individuals who are closely connected with him by blood relationship, relationship by marriage or by adoption and whose right to exercise family control and provide for these dependent individuals is based upon some moral or legal obligation."**

The law specifies that a **"dependent child"** must be under eighteen years of age or incapable of self-support because mentally or physically defective.

Thus an unmarried person may be the head of a family, as in the case of a son with aged parents or younger brothers and sisters (dependent children) dependent upon him for support.

Or a widow with dependent children would meet the requirement of the Department.

However, a widow or a widower, with no dependents, is entitled to only the exemption of $3000 allowed a single person who cannot qualify as the head of a family. And the married or single status of a person must be determined as of the last day of the year for which the return is filed. Should a man's wife die prior to the end of the year, even though she had lived the greater part of the year, his status, in the computation of income tax for the entire year, would be that of a single person and he would be allowed an exemption of only $3000 unless he could qualify as the head of a family or had been married again prior to the end of the year.

107.—HUSBAND AND WIFE.

The law provides that only one deduction of $4000 (as an exemption) can be made from the aggregate income of both husband and wife when living together, and that the additional exemption of $200 for each dependent child shall operate only in the case of one parent in the same family. If husband and wife file separate returns, either may claim the full amount of the exemption or they may prorate the amount between themselves.

108.—CREDIT FOR DEDUCTION AT SOURCE.

The total normal tax liability having been ascertained by taking credit according to the preceding paragraphs of this chapter, the individual has the right to credit such total normal tax liability with the amount of normal tax, if any, which has been deducted at the source. When this credit has been taken, the result should be the amount of normal tax due the government.

109.—ADDITIONAL TAX DIFFERENT.

Of the credits mentioned in this chapter only one is allowable against net income for the purpose of ascertaining **additional tax liability.** That is the credit for amount of excess profits tax assessed for

the same tax year. Only by such amount can the net income shown by a return be reduced before the additional tax is computed.

The amount represented by dividends can be deducted from net income and the specific exemption claimed **only in the computation for the normal tax.** It also follows that the amount of normal tax withheld at the source is not to be considered in the computation for the additional tax.

CHAPTER VIII

THE INCOME TAX

FILING OF INDIVIDUAL RETURN

110.—PERIOD COVERED.

The individual return of income is based upon the calendar year beginning January 1 and ending December 31. In this the language of the law is specific. The individual is not allowed the privilege of filing a return according to a fiscal year, as is the corporation. The Government recognizes just the one income-tax period with respect to the individual and that is the Calendar year.

111.—WHEN TO BE FILED.

The individual return of income must be filed on or before the first day of March for the preceding Calendar year. This means that a return for the year 1917 must be filed on or before March 1, 1918.

There are two distinct penalties provided for neglect or refusal to file a return within the time prescribed by law.

One takes the form of an addition of 50 per cent of the amount of tax shown to be due.

The other is what is known as the specific penalty and consists of a fine of not less than $20 nor more than $1000.

With respect to either of these penalties, however, the taxpayer should read the appropriate paragraphs in the chapter on **"Penalties, Offer in Compromise and Prosecution."**

112.—BY WHOM TO BE FILED.

In view of the fact that the two income tax laws (Act of September 8, 1916 and Act of October 3, 1917) are to be administered together, the question of liability to file a return for the year 1917 and subsequent years must be determined by the provisions of the act by which the amount of net income necessary to create such liability has

been reduced. That act is the Act of October 3, 1917. Under it a return must be filed by every individual, who is a citizen or resident of the United States, according to the following circumstances:

(a) A single person with a net income for the year of $1,000 or more.

(b) A married person, living with wife or husband, with a net income for the year of $2,000 or more.

A non-resident alien, not being subject to the War income tax, imposed by the Act of October 3, 1917, still has his liability to file a return fixed by the provisions of the Act of September 8, 1916, alone, and these provisions are that every non-resident alien with a net income from sources within the United States of $3,000 or more is required to file a return.

A point in this connection deserving emphasis is that **liability to file a return** is not the same as **liability to tax.** It is important that the distinction be understood. Under the law a single person with a net income of exactly $1,000, or a married person with a net income of exactly $2,000, is required to file a return; yet neither would have any tax to pay. Penalty could be imposed, however, for failure to file. Many returns are filed on which no tax is assessed.

113.—HOW FILED.

The filing of a return means the delivery of the return to the Collector of Internal Revenue. **And this must be accomplished on or before the first day of March.** Filing with a Deputy Collector is regarded the same as filing with the Collector.

If a return is mailed it should in every instance be forwarded under either a registry or special delivery stamp, so that the taxpayer may obtain a receipt showing the time of the arrival of the return in the hands of the Collector.

Mailing a return on or before the first day of March is not regarded as compliance with the law unless sufficient time is allowed for the return to reach the Collector, **in the ordinary course of the mail,** within the time prescribed. These points are not trivial; indeed, their importance cannot be too strongly emphasized, for many a penalty has been imposed in the face of proof that the return was **mailed on or before the first day of March** but not in time to reach the Collector's office before the expiration of the time limit.

114.—RECEIPT FOR RETURN.

The taxpayer is entitled to a receipt from the Collector for the filing of a return. He should ask for this receipt, whether he file in

person or by mail. The receipt is not ordinarily issued, but the Treasury Department has provided a form and instructed Collectors to issue a receipt whenever one is requested. The suggestion is, therefore, made that the taxpayer ask for a receipt for his own protection. Experience has shown that in the rush of work during the filing period returns are misplaced or lost after they have been regularly filed.

115.—WHERE FILED.

The return should be filed with the Collector of the district in which the individual resides. The law provides that it be filed in the district where the individual has his legal residence or principal place of business, but the Treasury Department has directed that residence determines the place of filing.

116.—FORM TO BE USED.

The return must be made on a form to be obtained from the Collector of Internal Revenue, at his headquarters, or from one of his deputies at a branch office. This form can be obtained by writing and asking for the **form for individual return.** [Prior to recent amendment of the law this form was No. 1040. Presumably the same designation will apply when the revised forms are issued.]

The return must show all income received during the preceding calendar year (except income which is exempt from tax), all deductions (with proper explanations) and the specific exemption which the individual claims. All information called for by the return must be given in the spaces provided for it.

The name and address must be plainly written on the first page. And in every instance the return must be made under oath. It may be sworn to before any officer qualified to administer an oath, or before the Collector or one of his deputies.

117.—EXTENSION OF TIME.

In certain cases it is possible to obtain an extension of time for filing. In cases of sickness or absence the Collector has authority to grant an extension not to exceed thirty days from March 1. When this extension is desired application must be made in writing to the Collector and reason given. It is useless to apply to the Collector for an extension for any other reason than sickness or absence, as the law limits his authority. However, a person residing or traveling abroad and unable to file his return on or before March 1, can obtain a further extension of time from the Commissioner of Internal Revenue, provided his case is meritorious. If this further extension is

required written application should be made to the Collector with the request that he transmit the application to the Commissioner, whose office is in Washington, D. C.

When a return is filed, after an extension of time has been obtained, notation of the extension should be made on the top margin and, if possible, a copy of the letter granting the extension should be attached; otherwise the person filing the return will be regarded as delinquent and will be liable to penalty.

118.—KEEP COPY OF RETURN.

Each individual should retain for his files a copy of his return. If an extra copy of the official form can be obtained, the retained copy should be kept on it; otherwise a form for the retained copy should be improvised. This is important to the taxpayer in the event he should later be investigated by a field officer.

119.—AGENT OR GUARDIAN MAY FILE.

When by reason of minority, insanity, absence, sickness or other disability one is unable to make his own return, his guardian or duly authorized agent must act for him and comply in full with the law and be subject to the same penalties as his principal. The Treasury Department has held, however, that a person acting merely under a power of attorney for the management of property, where no legal trust has been created, does not have to assume the responsibility of making an income tax return for his principal.

120.—NOTICE TO DELINQUENTS.

After the returns filed on or before March 1 have been properly recorded the Collector of Internal Revenue is required to notify every delinquent of whom he has knowledge and who has not filed that a return is expected within ten days. With this notice he is supposed to reach not only those who have filed returns in previous years but also those concerning whose affairs he has been able to obtain sufficient information to lead him to believe that they are liable to file returns.

Immediate attention must be paid to such notice whenever it is received. If a person's income has fallen below that of previous years, a letter of explanation should be written. If the recipient of the notice has not received the income which the Collector suspects him of having received, he should write in full.

121.—COLLECTOR CAN MAKE RETURN.

The law gives the Collector authority to call witnesses and examine accounts in case of neglect or refusal to file a return. He can,

indeed, make the return himself and such return would be acceptable as a basis of assessment of tax. [See similar paragraph in instructions given corporations.]

122.—CORRECTION OF A RETURN.

Whenever a return is received back from a Collector with instructions to alter it, the directions of the Collector should be studied with care. The taxpayer is not obliged to follow arbitrary instructions or comply with a peremptory demand with respect to any deduction he has claimed, for instance, unless such instructions or demand are accompanied by an explanation of the law and regulations. **In other words, before he is obliged to alter his return or prepare a new one, the taxpayer has the right to be shown the mistake in his original return.** He has the right to present his side of the case and should do so. And when he prepares the corrected or amended return he should mark it **"Amended"** and, in forwarding it to the Collector, attach to it the original incorrect return. This is necessary in order that he be given credit for having filed a return within the time prescribed by law.

123.—FRAUDULENT RETURN.

For the filing of a false or fraudulent return with intent to evade tax the law provides two distinct penalties. One is an increase of 100 per cent in the amount of tax found to be due, and the other is a fine not exceeding $2000 or imprisonment not exceeding one year, or both.

124.—ON BASIS OTHER THAN RECEIPTS.

While the law primarily requires that a return be based upon **income received** and **deductions actually paid out** during the year for which the return is made, it does contain an important exception in this respect with reference to an individual in the following language:

> "An individual keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect his income, may, subject to regulations made by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, make his return upon the basis upon which his accounts are kept, in which case the tax shall be computed upon his income as so returned." [See similar paragraph in instructions given corporations.]

CHAPTER IX

THE INCOME TAX

NON-RESIDENT ALIEN INDIVIDUALS

125.—EXTENT OF TAX LIABILITY.

A non-resident alien individual must pay income tax on all income from sources within the United States, except specifically exempted income. **A resident alien**—that is, an alien residing in the United States—must pay tax on income from all sources, both within and without the United States, except specifically exempted income, the same as an American citizen; but a non-resident alien is liable only to the extent of his net income from the United States.

126.—NOT LIABLE TO WAR INCOME TAX.

A non-resident alien is, however, liable only under the old law (the Act of September 8, 1916.) His net income from sources within the United States is not subject to the extra rates imposed by the Act of October 3, 1917.

127.—WHAT CONSTITUTES RESIDENCE.

It becomes necessary, therefore, to obtain an exact understanding of what the law means by the adjectives, "Resident" and "Non-resident." In Treasury Decision 2242 the Department has held that "residence" is "that place where a man has his true, fixed and permanent home and principal establishment, and to which whenever he is absent, he has the intention of returning; and indicates permanency of occupation as distinct from lodging or boarding, or temporary occupation. For the purpose of the income tax, it is held that where for business purposes or otherwise, an alien is permanently located in the United States; has there his principal business establishment and is there permanently occupied or employed, even though his domicile

may be without the United States, he will be held to be within the definition of 'every person residing in the United States, though not a citizen thereof.' "

In application of the above ruling the Department has held that "aliens who are physically present in the United States, but only temporarily resident or employed therein (as for a season or similarly definite term, and with the expectation or intention of leaving the United States upon the termination of employment or accomplishment of the purpose which necessitated presence in the United States), are within the class of 'Persons residing elsewhere' "—that is, are non-resident aliens.

An alien who has come to the United States with the intention of becoming a permanent resident is, under the general interpretation of the law, a resident alien.

An American woman who marries a foreigner assumes the nationality of her husband and is, for the purposes of the income tax, a resident or a non-resident alien according to his status with respect to residence.

128.—NO SPECIFIC EXEMPTION ALLOWED.

A non-resident alien is **not allowed** the specific personal exemption enjoyed by citizens and residents of the United States. By this exemption is meant the allowance of $3,000 or $4,000, according to single or married status.

And, likewise, **the specific exemption of $3,000,** given to

(a) estates of deceased citizens or residents of the United States during the period of administration or settlement, and to

(b) trust or other estates of citizens or residents of the United States, the income of which is not distributed annually or regularly,

is not allowed to similar estates of non-resident aliens.

129.—NET INCOME OF NON-RESIDENT ALIEN.

The net income of a non-resident alien is ascertained by taking from gross income from sources within the United States the deductions allowed by law.

130.—DEDUCTIONS LIMITED.

These deductions are limited, however, to expenditures or losses immediately connected with or related to the sources within the United States from which the non-resident alien reports his income.

The reader is referred to definitions of deductions in instructions given citizens and residents for detailed information. Certain specific limitations may, however, be noted here as follows:

1. Expenses only of business or trade carried on in United States.

2. Interest—that proportion of all interest which gross income from United States bears to gross income from all sources (less interest on indebtedness incurred to buy bonds the interest on which is exempt from income tax.)

3. Taxes paid in the United States, except those assessed against local benefits; (Taxes imposed by a foreign government are not deductible by a non-resident alien); except also United States Income and excess profits taxes.

4. Losses in trade in United States.

5. Losses (speculative) not exceeding profits from similar transactions in United States.

6. Bad debts arising from business conducted in the United States.

7. Depreciation of business property and depletion of natural deposits only in the United States.

131.—CREDITS FOR NORMAL TAX.

As in the case of a citizen or resident of the United States, a non-resident alien is allowed credits against net income of the amounts representing dividends from taxable corporations and income taxed at the source, in the computation for the normal tax. These credits are not allowed, however, in assessing the additional tax.

132.—BOTH NORMAL AND ADDITIONAL TAX.

A non-resident alien is subject to both the normal and the additional tax under the rates of the Act of September 8, 1916, according to the amount of his income.

However, were his entire income from corporation dividends, and in excess of $20,000 for the year, he would (under the Income Tax law of September 8, 1916, as amended) be subject only to the graduated additional tax.

133.—MUST MAKE RETURN.

In order to receive the benefit of deductions and credits, the law requires that a non-resident alien shall make an accurate return of all income, except exempt income, from sources within the United States,

including dividends. If he fails to file such a return, the Collector of Internal Revenue must proceed to collect the tax due on his income and may take and sell any of his property to satisfy the Government's claim.

134.—WHERE TO FILE RETURN.

A non-resident alien is directed to file his return of income in the district in which he carries on his principal business within the United States. However, if he has no such principal business, and in all cases of doubt, he may and should file with the Collector at Baltimore, Md., in whose district Washington, D. C. is situated.

135.—AGENT CAN MAKE RETURN.

The return of a non-resident alien can be made by a resident agent in the United States. In fact, the Department in formal Treasury Decisions and extensive correspondence has insisted that in all cases where resident agents are responsible for the American interests of their principals to the extent of being in charge of any property owned, or business carried on, such resident agents must make the returns. The resident agent can act in full for his non-resident alien principal, can swear to the return and pay the tax assessed. Moreover, such resident agent may be either an individual or a corporation. If a corporation acts as resident agent, such corporation can sign, by one of its responsible officers, the individual return made in behalf of its non-resident alien principal.

The return herein referred to (which is to be made by agent for principal) is the return of annual net income required of the non-resident alien individual, and not the withholding agent's return required in the case of deduction of tax at the source.

136.—TRUSTEE OR EXECUTOR TO MAKE RETURN.

A trustee, executor, administrator, or any person acting in a fiduciary capacity can make the individual return for a non-resident alien beneficiary. **This has reference to a return similar to that which would be made by an agent** and **not to** the return required to be filed for the estate of a deceased person during the period of administration, or to the return required of any other estate the income of which is not annually or regularly distributed, or to the withholding agent's return required of a fiduciary when such fiduciary comes under the provisions of the law relative to deduction of the normal tax at the source.

137.—DEDUCTION OF TAX AT SOURCE.

All the income of a non-resident alien individual from the United States is subject to deduction of the normal tax at the source except income from dividends on the stock of a corporation subject to income tax. Such is the requirement of the law of September 8, 1916, as amended by the War Revenue Act of October 3, 1917. All persons, corporations or partnerships having control of the payment of any income **except corporation dividends** to a non-resident alien must deduct the normal tax, as prescribed by law, and make return and payment of such tax to the Collector of Internal Revenue. [This is more fully explained in the special chapter on **["Deduction of Tax and Information at Source."]**

138.—FOREIGN DIVIDENDS.

A non-resident alien is not required to include in his return of income any amount received as dividends on the stock of foreign corporations, whether such dividends are payable either in the United States or abroad. Particular attention is called to this, lest the requirement that all dividends be included in a return be misunderstood as far as its application to non-resident alien individuals is concerned.

CHAPTER X

THE INCOME TAX

PARTNERSHIPS

139.—NOT SUBJECT TO INCOME TAX.

A partnership, as such, is not subject to income tax—except a limited partnership which has been held by the Treasury Department to be an "association," within the meaning of the law, liable to make return and pay tax. An ordinary partnership has no income-tax liability. The **individual members** of a partnership must, however, include in the **gross income** stated in their individual returns their respective shares of the **net earnings** of the partnership, whether such earnings have been distributed or not.

140.—INCOME FROM A PARTNERSHIP.

The requirement that each individual member of a partnership account for his share of its net earnings as a part of his gross income, whether he has actually received such share by way of distribution or not, has necessitated careful definition of income from a partnership.

The Department holds that income from a partnership accrues to the individual partner at the time his distributive interest has been ascertained and is reducible to possession. In his own return for the calendar year the individual partner must include income accruing from the business of the partnership for its business year as such income is shown by the books of the partnership, whether or not distribution has been made to the partners. The net earnings of the partnership thus to be accounted for by the individual members are the net earnings for the business year of the partnership ending in the calendar year for which the individuals make their return.

For example: The partnership of **"A & B"** closed its books on September 30, 1917. In their personal returns for the calendar year ending December 31, 1917, **A** and **B,** as individuals, must include their

respective shares of the net earnings of the partnership, as shown by the books on September 30, whether or not such net earnings have actually been distributed.

If the partnership's business year should close the last day of December, then the partners would include in their returns for the year ending the last day of December their respective shares of the net earnings as shown by the partnership's books on that date.

It follows, of course, that if the net earnings of a partnership are not actually distributed during the year for which the individual partners account for them in their personal returns, such net earnings, when actually paid to the partners, need not again be included as income received.

141.—CREDITS AGAINST PARTNERSHIP EARNINGS.

As the individual partner is required to include in his statement of gross income his share of a partnership's net earnings, he would, in many cases, be subjected to both normal and additional tax on his share of that part of the partnership's income represented by interest on those certain bonds (enumerated hereinbefore) the interest on which is exempt from tax; and he would be subjected to normal tax on his share of that part of the partnership's income represented by dividends from corporations, **but for credits** specifically provided for in the law as follows:

> That from the net distributive interests on which the individual members shall be liable for tax, normal and additional, there shall be excluded their proportionate shares received from interest on the obligations of a State or any political or taxing subdivision thereof, and upon the obligations of the United States (if and to the extent that it is provided in the Act authorizing the issue of such obligations of the United States that they are exempt from taxation) and its possessions.
>
> And that for the purpose of computing the normal tax there shall be allowed a credit * * * * * for their proportionate share of the profits derived from dividends.

142.—RETURN MAY BE REQUIRED.

While a partnership is not liable to income tax and does not, in the ordinary course of its business, have to file a return, the statute gives both the Commissioner of Internal Revenue and a district Collector of Internal Revenue authority to call for a return. At any time either the Commissioner or a Collector may request a partnership to file a return, and such request must be complied with. Moreover, such return, when filed, must give a complete statement of the gross income of the partnership, and of the deductions and credits to which it is entitled, and the name and address of each individual partner interested in the net earnings of the partnership.

Since the partnership, as such, is not subject to income tax, this return, when called for, is for the information of the officials of the Government and not for assessment of tax against the partnership. As a matter of fact, the purpose in calling for it would be to obtain data desired in checking the personal returns of the individual partners.

The return should not be filed unless called for by either the Commissioner or a Collector.

143.—CAN FIX A FISCAL YEAR.

A partnership can designate a fiscal year of its own, and make return upon such basis, if called upon to make return. It has the same rights in this respect as a corporation.

144.—WHEN TAX RATE CHANGES.

If the fiscal year of a partnership should at any time comprehend parts of two calendar years for which there are different rates of tax, then each partner's share of its net earnings must be apportioned for taxation under the two rates, according to that portion of the partnership's fiscal year falling within each of the two calendar years.

145.—PARTNERSHIP MUST WITHHOLD TAX AND GIVE INFORMATION AT SOURCE.

Under the income tax law of 1916, as amended by the War Revenue Act of October 3, 1917, a partnership is under the same requirements as a withholding agent with respect to deduction of the normal tax at the source as are corporations and individuals. These requirements have been greatly reduced from those that were in the law prior to amendment on October 3, 1917.

If a partnership engages in the business of making collection of foreign payments of interest or dividends, it must obtain a license and submit to the same regulations as are imposed upon corporations and individuals.

With respect to **information at the source,** regarding payments to others, the partnership stands exactly as does the corporation or individual. It is subject to the same general requirements and liable to the same general penalties for refusal or neglect to obey the law.

[See chapter on **"Deduction of Tax and Information at Source."**]

146.—CANNOT DEDUCT INSURANCE PREMIUMS.

In computing its net earnings, in order that the individual partners may account for their respective shares in their personal returns, a partnership is not allowed to deduct from gross income premiums

paid on policies insuring the lives of individuals, (members or employees) in favor of the business. This prohibition was written into the law by the Act of October 3, 1917.

Prior to such amendment the ruling was that while the annual premium could not be deducted, as paid from year to year, the aggregate of premiums paid could be deducted from the proceeds of the policy in ascertaining the amount of such proceeds to be included as income.

CHAPTER XI

THE INCOME TAX

DEDUCTION OF TAX AND INFORMATION AT SOURCE.

147.—LAW RADICALLY CHANGED.

The requirements of the Income Tax law with respect to the deduction and withholding of the normal income tax at the source were radically changed by amendments carried by the Act of October 3, 1917. Certain of the deduction-at-the-source features have been retained and for others have been substituted requirements that information be furnished from the source without deduction of the tax.

148.—INCOME OF CITIZENS OR RESIDENTS OF UNITED STATES.

All of the requirements relative to the deduction of the normal tax from the income of individuals who are citizens or residents of the United States have been repealed with the exception of that relating to interest on bonds containing the so-called "tax-free" covenant. Only in this one respect is a corporation or its paying agent required to deduct the normal tax, and then only at the rate of 2 per cent. The individual can, however, claim exemption for deduction at the source, in which case no tax is to be deducted. In collecting his interest the bondholder must fill out an ownership certificate. In this certificate he can either claim exemption from deduction of tax at the source, or not claim exemption. If he does not claim exemption, the corporation must pay the normal tax upon the interest.

In either case original tax liability remains with the bondholder—the recipient of the interest. This liability is not transferred from bondholder to corporation by the "tax-free" covenant in the bond.

If the bondholder claims exemption in filing his certificate of ownership at the time he collects his interest, when the time comes to file his return of annual income with the Government he must enter the amount of interest received as income which **has not been subjected to tax at the source.**

If the bondholder does not claim exemption in filing his certificate of ownership at the time he collects his interest, when the time comes to file his return of annual income with the Government he must enter the amount of interest received as income which **has been subjected to tax at the source.**

It is of the utmost importance that the two preceding paragraphs be understood by every individual holder of "tax-free" industrial bonds. Endless confusion has resulted from a clash between the withholding provisions of the Federal law and the "tax-free" covenant in such bonds.

To illustrate:

John Smith owns $20,000 (par value) of the Western Railway Company's bonds paying 5 per cent interest. The interest is payable quarterly. There is a clause in the bonds by which the railway company agrees to pay the interest without deduction for taxes. What happens if Smith, desiring to pass liability for the tax to the railway company, decides that the way to do so is to claim exemption when he fills out the ownership certificate required when he collects his interest?

Having claimed exemption in collecting a year's interest, he decides that he is no longer liable to tax on the interest and when he makes up his return of income he enters the amount of interest as having been taxed at the source. **This is not what should be done** but it is what generally has been done by the individual during the past four years.

The mistake made by Smith may not be noticed in the local Internal Revenue office during the rush of the filing period, but eventually it will be discovered in the Department at Washington where all ownership certificates are filed and assembled, and Smith will be assessed and required to pay the tax on the interest. When he protests that the bonds are "tax-free," he will be told that the Government is not concerned with the "tax-free" covenant, that the liability is his and that in claiming exemption at the time he filled out ownership certificates he specifically released the railway company from liability to pay the tax to the Government under the provisions of the Income Tax law.

On the other hand, if at the time he collects his interest and fills out the requisite ownership certificates, Smith does not claim exemption, the railway company is under obligation to pay the tax to the Government. Smith, then, can enter the amount as having been taxed at the source when he files his return of income. He can make this kind of entry and benefit by the credit represented by it even though he has received his interest in full, which generally has happened in the case of interest payments on "tax-free" bonds, whether the bondholder has or has not claimed exemption.

The form of ownership certificate used by the bondholder is what determines the liability of the bond-issuing corporation as far as the Government is concerned. The Government requires that the corporation make return and pay the normal tax in the case of every interest payment for which a certificate claiming exemption cannot be furnished. But with respect to interest payments for which it has received ownership certificates claiming exemption, the corporation is required merely to deposit the certificates with the Collector for transmission to Washington and is not required to pay tax at the source.

149.—INCOME OF NON-RESIDENT ALIEN INDIVIDUALS.

All of the income of non-resident alien individuals, from sources within the United States, is still subject to the deduction of the normal tax at the source with the exception of dividends from domestic corporations.

All persons, corporations, partnerships and associations, having control, receipt, custody, disposal or payment of income of any kind, **except dividends,** from the United States to foreigners residing under other flags must deduct the normal tax of 2 per cent and make return and payment to the Collector of Internal Revenue. Moreover, a non-resident alien, not being entitled to the specific exemption allowed other individuals, can not claim exemption from deduction at the source.

150.—INCOME OF FOREIGN CORPORATION FROM UNITED STATES.

The income of a foreign corporation from sources wthin the United States is subject to deduction of tax at the source in two respects, provided such corporation is not engaged in business or trade in the United States and does not have an office or place of business in this country.

1.—The income derived by such a corporation from dividends on the stock of a domestic corporation is subject to deduction of tax at the source to the amount of 2 per cent.

2.—The income derived by such a corporation from interest on American corporation bonds is subject to deduction of tax at the source to the amount of 6 per cent.

151.—FOREIGN PARTNERSHIP NOT SUBJECT TO DEDUCTION AT SOURCE.

Payments of domestic corporation dividends or bond interest, or of income in any other form, to a foreign partnership is not subject to deduction of tax at the source. True,, Subdivision (e) of Section 13 of the Act of September 8, 1916, as amended by the Act of October 3, 1917, states that the withholding-at-the-source requirement with respect to bond interest "shall be made applicable **to the tax imposed by subdivision (a) of Section 10** (of the Act of September 8, 1916) upon incomes derived from interest upon bonds and mortgages or deeds of trust or similar obligations of domestic or other resident corporations, joint-stock companies, or associations, and insurance companies, **by non-resident alien firms, copartnerships,** companies, corporations, joint-stock companies or associations, and insurance companies, not engaged in business or trade within the United States and not having any office or place of business therein."

But Subdivision (a) of Section 10, above referred to, does not impose an income tax upon the income of foreign partnerships; therefore, no tax is to be deducted when payments are made to them. The Department has so held.

152.—DOMESTIC CORPORATIONS AND PARTNERSHIPS NOT SUBJECT TO DEDUCTION AT SOURCE.

The income of a domestic corporation or partnership is not subject to deduction of the tax at the source upon income paid in any form. It has in the past been held necessary, however, for such organizations to file ownership certificates when presenting bond coupons or interest orders for collection. Under the law as amended they will still have to do so with respect to coupons and interest orders for interest payments upon "tax-free" bonds.

153.—WHO IS "WITHHOLDING AGENT"?

The regulations of the Treasury Department and the official income tax forms contain many references to "withholding agents."

The withholding agent is the source of the income.

In the case of bond interest payments the withholding agent is the interest-paying corporation or its regularly designated paying agent.

In the case of payment of salaries, rent, etc., the withholding agent would be the employer, lessee, etc., making such payments to a non-resident alien.

In the case of dividend payments by a domestic corporation to a foreign corporation having no office or place of business in the United States, the withholding agent would be the domestic corporation.

A withholding agent can be an individual, a corporation, a partnership or any kind of association or organization.

154.—REFUND OF TAX WITHHELD IN 1917 AUTHORIZED.

All amounts of tax withheld at the source during 1917 from the income of individuals who are citizens or residents of the United States, with the exception of that withheld from interest payments on "tax-free" bonds, must be returned to the owners. This covers amounts withheld from salaries, rents, ordinary note interest, and any other form of income of an individual citizen or resident of the country which was formerly subject to deduction of tax at the source. Employers, lessees and others who withheld the tax from payments made during the year 1917, are authorized and directed by law to pay back the amounts. The Government will expect the individuals receiving the income to include all such income in their returns as not having been taxed at the source.

155.—DUTIES OF THOSE WHO DEDUCT TAX UNDER AMENDED LAW.

Those persons, corporations or partnerships

(a) making payments of any kind, except domestic corporation dividends, to a non-resident alien individual;

(b) or making payments of "tax-free" corporation bond interest to an individual citizen or resident of the United States, when the certificate of ownership filed does not claim exemption;

(c) or making payments of domestic corporation dividends and any domestic corporation bond interest (whether bonds are "tax-free" or not) to a foreign corporation not engaged in business or trade in the United States and not having an office or place of business in this country,

will be required to make return and pay the tax deducted to the Collector of Internal Revenue of the district in which such "withholding agent" has his or its principal place of business.

In the case of payment of bond interest they must require the filing of ownership certificates in one of the several forms provided, and they must make both monthly and annual returns to the Collector. In regard to other payments annual returns will be filed.

For neglect or refusal to file such a return of tax deducted and withheld at the source the person, corporation or partnership under liability to do so is subject to fine and to an increase of the amount of tax by 50 per cent.

Every person, corporation or partnership making any payment subject to deduction of the tax at the source, as hereinbefore explained, should write to the Collector of Internal Revenue, state the kind of payments made, and request the forwarding of official forms of ownership certificates and returns.

156.—USE OF OWNERSHIP AND OTHER CERTIFICATES.

Various forms of ownership certificates and other certificates have been provided for the use of those in receipt of income. They were issued under the law before recent amendment and may be slightly altered during administration of the law as amended; however, in general the certificates will be used as follows:

Form 1000—Ownership certificate in which exemption is not claimed. To be used by individuals, citizens or residents of the United States, with coupons or interest orders when collecting the interest paid upon corporation bonds.

Form 1000 B—Ownership certificate in which exemption is claimed. To be used by individuals, citizens or residents of the United States, with coupons or interest orders when collecting interest paid upon corporation bonds.

Form 1001—Ownership certificates to be used by domestic firms, corporations or organizations, the income of which is not subject to deduction of tax at the source. This certificate is to be used in collecting interest paid upon corporation bonds. It has the effect of a certificate claiming exemption.

Form 1002—Certificate to be used in lieu of owner's certificate by a bank or other collecting agency in collecting interest paid upon corporation bonds, when such bank or other agency has purchased or

accepted for collection from individuals coupons or interest orders that were not accompanied by certificates signed by such individual bondholders. The use of this certificate (1002) has the effect of a certificate claiming exemption as far as the paying corporation is concerned, but it makes the bank or other collecting agency using it liable for the return and payment of the normal tax of 2 per cent upon the interest represented by coupons or interest orders so handled.

Form 1004—Ownership certificate to be used by non-resident alien individuals with coupons or interest orders when collecting interest paid upon domestic bonds. This is not an exemption certificate. It is merely an identification ownership certificate and the normal tax of 2 per cent must be withheld from any payment thus identified.

Forms 1015 and 1019—Certificates in lieu of ownership certificates by which a fiduciary in receipt of bond interest payments belonging to a beneficiary for whom he acts either does or does not take over liability as withholding agent. The use of Form 1015 does and the use of Form 1019 does not release the interest-paying corporation from withholding liability.

Forms 1058 and 1059—Substitute certificates used by a collecting agent and substituted for certificates signed by the owners of the bonds. If exemption is claimed by the owner of the bonds and at the same time it is not desired to disclose ownership to the paying corporation, the collecting agent may forward directly to the office of the Commissioner of Internal Revenue at Washington the certificate signed by the owner of the bonds and may then transmit the coupons or interest orders for payment accompanied by his own substitute certificate on Form 1058, such substitute certificate on Form 1058 being received by the interest-paying corporation as an exemption certificate. Form 1059 is used in the same way, except that it is the substitute certificate form to be forwarded with the coupons or interest orders when the owner does not claim exemption. Form 1059 does not release the interest-paying corporation from liability to withhold the tax.

Form 1071—An exemption certificate for the use of responsible banks or bankers, either foreign or domestic in behalf of non-resident owners of stocks and bonds of foreign corporations, when payments are made in the United States.

Form 1078—Certificate of residence to be filed by an alien with withholding agents for the purpose of gaining the status of a resident

alien when otherwise the individual's status would be that of a non-resident alien.

Form 1086—Certificate to be filed with withholding agent by foreign corporations, etc., which have an office or place of business in the United States, so that the tax upon bond interest and dividends from domestic securities will not be withheld as in the case of corporations having no office or place of business in this country.

Form 1087—Certificate to be used to disclose the actual ownership of stock when the record owner is other than the actual owner.

157.—ONLY 2 PER CENT WITHHELD.

With the two income tax acts (Acts of September 8, 1916 and Act of October 3, 1917) in effect the individual who is a citizen or resident of the United States is subject to two normal taxes, at the rate of 2 per cent for each tax. The law provides, however, that the deduction-at-the-source requirements shall not apply to the War normal tax imposed by the Act of October 3, 1917 until January 1, 1918, and that even thereafter deduction at the source from the income of individuals shall not be at a rate higher than 2 per cent. The remainder of the normal tax is to be returned and paid by the person receiving the income. This does not affect non-resident alien individuals because they are not subject to the War normal tax; and it affects individuals who are citizens or residents of the United States only so far as their income from interest upon "tax-free" corporation bonds is concerned.

158.—INFORMATION AT SOURCE.

The provisions calling for information at the source are practically all new. They are taken up with respect to the different kinds of payment affected:—

—1.—

Corporations To Report Dividend Payments.

Every corporation, when required to do so by the Commissioner of Internal Revenue, must make a statement, under oath, of its payment of dividends, whether such payment is made in cash or its equivalent or in stock. The statement must disclose the name and address of each stockholder, the number of shares owned by each, and the years in which the dividends were earned, with the amounts belonging to the several years stated. This report should be made,

when required, on an official form to be obtained from the Collector of Internal Revenue.

—2.—

Brokers To Report On Customers' Dealings.

Every person, corporation, partnership or association, doing business as a broker on any exchange or board of trade or similar place of business, must, when required to do so by the Commissioner of Internal Revenue, make a statement under oath regarding the transactions of customers. This statement must disclose the name of each customer and all the details of his profits or losses and such other information as the Commissioner may require. The report should be made, when required, on an official form to be obtained from the Collector of Internal Revenue.

—3.—

Corporations to Report Bond Interest Payments.

Every corporation is required to report, under oath, every payment of interest upon its bonds, **regardless of the amount paid.** The statute itself requires that this report be made; the duty of making the report is not left to the pleasure of the Commissioner. The statement must show the amount of interest paid each individual, partnership or corporation and the name and address of each. It must also be made on an official form to be obtained from the Collector of Internal Revenue.

—4.—

Report Required On Foreign Collections.

A report, under oath, is also **required by law** in the case of the collection of foreign items of income, **regardless of the amount,** as follows:

The report must be made by every person, partnership, corporation or association, undertaking the collection as a matter of business or for profit, by means of coupons, checks or bills of exchange, of (a) interest paid upon the bonds of foreign countries, (b) interest paid upon the bonds of foreign corporations, and (c) dividends paid upon the stock of foreign corporations.

The report must give the name and address of each recipient of such income (whether such recipient be an individual, partnership or

corporation), the character of the income and the amount collected for each.

Every person, partnership or corporation undertaking as a matter of business or for profit the collection of the above described foreign items **must first obtain a license from the Government.** Application for this license should be made to the local Collector of Internal Revenue. The undertaking of such collections without having first obtained a license is a serious offense, punishable by a fine not exceeding $5,000, or by imprisonment for not more than a year, or both.

—5.—

General Information On Other Payments.

Provision having been made, according to the preceding paragraphs, for reports relative to

(1) Dividend payments,
(2) Transactions through brokers.
(3) Bond interest payments, and
(4) Foreign collections,

there remain other payments to be taken care of.

The law provides that any such other payment of income of a **fixed or determinable character, of $800 or more** in any taxable year, must be reported. And in this case the obligation to make such report is imposed by the statute and not left to the pleasure of the Commissioner of Internal Revenue.

Every individual, partnership, corporation or association making such payments to another individual, partnership, corporation or association, must make a report, or return, under oath, to the local Collector of Internal Revenue, provided the total paid to any one recipient within the year is $800 or more. (It must be understood, in this connection, that the four kinds of payments described under preceding headings and enumerated immediately under this heading are not to be included in this report.)

The report must show the name and address of each recipient, the character of the income and the amount paid each. It must be made on an official form to be obtained from the Collector of Internal Revenue. The liability to make this report attaches to lessees or mortgagors of real or personal property, trustees acting in any trust capacity, executors, administrators, receivers, conservators, and employers—also all persons, firms or corporations paying interest other than bond interest.

159.—CERTAIN REPORTS REQUIRED BY LAW, OTHERS AS DEPARTMENT DEMANDS.

The provisions of the law with respect to information at the source having been discussed above under five separate headings, attention is called to the fact that certain reports are required by law and others as the Commissioner of Internal Revenue may ask for them. All, when made, must conform to the regulations made by the Department. These regulations had not been made when this book went to press but the official forms obtained from the Collector of Internal Revenue will show what must be reported and when the report must be filed. The reports discussed under headings No. 1 and No. 2, above, are to be made when required by the Commissioner; those discussed under headings No. 3, No. 4 and No. 5 are required by law.

—HOW TO OBTAIN OFFICIAL FORMS FOR REPORTS.

All official forms for reports are to be obtained from the local Collector of Internal Revenue. The forms not having been provided when this book went to press, the numbers of them are not known. However, they may be obtained, when provided by the Department, by personal or written application, making reference to report to be made under one or more of the following headings:

(a) Corporation dividend payments.

(b) Brokerage business.

(c) Bond interest payments.

(d) Foreign Collections.

(e) Payments aggregating $800 or more to one recipient and not including dividends, business transacted through brokers, bond interest payments or foreign collections.

161.—PENALTIES FOR FAILURE TO REPORT OR MAKING FALSE REPORT.

The penalty for failure or refusal to make a report of information as required by law and as outlined above is a fine of not less than $20 nor more than $1,000.

The penalty for making a false report is a fine of not more than $2,000, or imprisonment for not more than one year, or both.

162.—INDEFINITE INCOME NEED NOT BE REPORTED.

The law requires that in the case of payments aggregating $800 or more a year to one recipient reports be made only with respect to income which is of a **fixed or determinable character.** Income in the form of rent and salaries, and of interest other than bond interest, is of such fixed and periodical character; but the royalties paid on a mine or oil well, or from the use of a patent or sale of a copyrighted book, and the commissions paid salesmen are of a different character. Dependent for amount upon the extent of operations or the business done, they are indefinite and need not be included in a report of information from the source.

CHAPTER XII

THE INCOME TAX

ESTATES AND FIDUCIARIES UNDER THE LAW

163.—CERTAIN ESTATES TAXABLE.

The income tax law provides that a return shall be made and tax paid by estates in certain circumstances and, when the circumstances of administration make an estate amenable to the requirements of the statute, such estate virtually has the status of a taxable individual. The executors, administrators, trustees or other person or persons acting in the fiduciary capacity, are made responsible for filing the return and paying the tax, under all the penalties that apply in the case of individuals.

164.—ESTATE DURING SETTLEMENT.

The law provides that the "income received by estates of deceased persons during the period of administration or settlement shall be subject to the normal and additional tax and taxed to the estates."

In such a case the estate is treated as an entity. A return must be made, although such return need not be signed by more than one of the persons in charge of the estate as executors, administrators, or in other fiduciary capacity.

The estate reports its income just as an individual would do, and makes its deductions as far as such deductions are properly chargable against the income of the estate for the year in which the return is made. It must not be understood, however, that those expenses which should be charged against the principal of an estate are allowable as deductions. By the latter are meant such expenses as costs in court,

counsel fees, the fees or commissions of executors, and similar expenses—the Treasury Department has repeatedly held that such expenses are to be charged against the principal of the estate and can not be deducted in a return filed by the estate.

165.—TRUST ESTATES.

The law also provides that "income of estates or any kind of property held in trust, including such income accumulated in trust for the benefit of unborn or unascertained persons, or persons with contingent interests, and income held for future distribution under the terms of the will or trust shall be likewise taxed."

Any estate coming within the above provision must make a return just as an individual would do, and must pay the tax shown to be due, both normal and additional.

166.—INCOME DISTRIBUTED IN PART.

If any part of the income of an estate is not distributed annually or regularly—that is, if any part of the income is not distributed or distributable to known beneficiaries—then the estate becomes a taxable entity with respect to that part of the income and must make return, subject to full assessment of tax.

167.—ESTATES OF NON-RESIDENT ALIENS.

If the estate, which is required to make return and pay tax, under the law as above explained, is that of a non-resident alien, it follows that only the income of such estate from sources within the United States need be accounted for, also that only deductions related to such income are allowable.

168.—EXEMPTION ALLOWED ESTATE.

An estate of a deceased citizen or resident of the United States, when required to file return, is allowed to claim the benefit of a specific exemption of $3,000.

An estate of a deceased non-resident alien is not allowed any specific exemption.

169.—AMOUNT OF INCOME REQUIRING RETURN TO BE FILED.

The amount of net income that determines the question of an estate's liability to file a return as a taxable entity is $3,000, and this applies to estates both of citizens or residents of the United States

and of non-resident aliens. Although the estate may otherwise come within the provisions of law making it a taxable entity, it does not have to file return and pay tax unless its net income for the tax year amounts to $3,000 or more.

170.—WHEN DECEDENT DIES DURING TAX YEAR.

Under authority of paragraph (g) of Section 9 of the Act of September 8, 1916, the Treasury Department has held that a return must be filed by an executor or administrator in behalf of a person who has died during the year, if that person had during the year from January 1 to the date of his death a net income of $1,000 or more (in case of a single person) or $2,000 or more (in case of a married person). In such a return the full exemption that would be allowed the decedent were he living at the end of the year can be claimed, according to whether such person was single, married or the head of a family on the date of death. The executor or administrator is made liable for the filing of the return and payment of the tax.

This return is distinct from, and must not be confused with, any return of income which may subsequently be required in behalf of the estate as an entity should the estate come within the provisions of law fixing liability for a return in its behalf. And it is possible that both returns may have to be filed for the same year. Such would be the case were the decedent's net income for the year prior to his death $1,000 or more (in the case of a single person) or $2,000 or more (in the case of a married person), and were the estate of the character to make it a taxable entity and in receipt of a net income for the remainder of the year amounting to $3,000 or more.

CHAPTER XIII

THE INCOME TAX

ON CORPORATIONS

A great many of the instructions applicable to the affairs of an individual can also be applied to the income-tax problems that confront every corporation. It is therefore suggested that when information is desired on any point, and when the subject is found not to have been specially covered in instructions given for the guidance of corporations, in particular, the taxpayer consult the index for reference to the subject in the instructions given **individuals.** In other words, numerous general requirements of the law and of the regulations of the Treasury Department are common to the affairs of both corporations and individuals. In places, where it has been regarded advisable for the sake of clarity, these will be found to have been repeated, but not always; hence the subject should be followed carefully according to the index.

171.—WHAT CONSTITUTES A CORPORATION.

The language of the law imposing a tax upon "every corporation, joint-stock company or association, or insurance company * * * * * no matter how created or organized," except those specifically exempted, gives leeway for definition of the status of a taxable corporation. And here is the Treasury Department's definition (to be found in Articles 78 and 79 of Regulations No. 33, issued under date of January 5, 1914).

> " 'Corporation' or 'corpo ations,' shall be construed to include all corporations, joint-stock companies or associations, and all insurance companies coming within the terms of the law.
>
> "It is immaterial how such corporations are created or organized. The terms 'joint-stock companies' or 'associations'

shall include associates, real estate trusts, or by whatever name known, which carry on or do business in an organized capacity, whether organized under and pursuant to State laws, trust agreements, declarations of trust, or otherwise, the net income of which, if any, is distributed, or distributable, among the members or share-owners on the basis of the capital stock which each holds, or, where there is no capital stock, on the basis of the proportionate share of capital which each has invested in the business or property of the organization, all of which joint-stock companies or associations shall, in their organized capacity, be subject to the tax."

172.—CORPORATIONS LIABLE.

Under the law every corporation, joint-stock company or association, or insurance company, organized in the United States, no matter how organized or created, and **not specifically enumerated as exempt,** is required to pay tax, upon total net income received.

Also every corporation, joint-stock company or association, or insurance company, organized or existing under the laws of a foreign country, is required to pay tax upon **total net income** received from all sources within the United States.

Thus taxable corporations may be divided into the two general classes—**domestic** and **foreign.**

173.—CORPORATION TAX RATE.

The rate of tax under the old law (Act of September 8, 1916) is 2 per cent on total net income. The rate under the new law (Act of October 3, 1917) is 4 per cent, except that in the computation at the latter rate credit is allowed for dividends from another corporation. Both rates are in effect. The tax is imposed at a flat rate in each instance, and total tax liability is to be ascertained by computing tax under both laws, with special consideration of dividends received from another corporation, as just noted and as explained in detail elsewhere in this book under appropriate heading. (See Index). A corporation is not subject to the graduated additional tax.

174.—CORPORATION TAX ON UNDISTRIBUTED NET INCOME.

A new provision in the law, resulting from amendment by the War Revenue Act, is that imposing a tax upon undistributed net income of a corporation in certain circumstances and subject to specified exemptions and restrictions.

This tax is to be imposed at the rate of 10 per cent only when all or a part of the net income which has been disclosed by a corporation in its return of income for the Calendar or its own fiscal year remains undistributed six months after the close of such Calendar or fiscal year. But even then, not all of such undistributed net income is subject to tax. The following exemptions are to be noted:

(a) An amount of such undistributed net income equal to the income tax paid by the corporation within the year.

(b) That portion of such undistributed net income which is actually invested and employed in the business or is retained for employment in the reasonable requirements of the business.

(c) Amount invested in obligations of the United States issued after September 1, 1917.

With reference to sub-parargraph (b), above, the Secretary of the Treasury is authorized to penalize a corporation by assessing this tax at the rate of 15 per cent, instead of 10 per cent, if he should find that any portion of the undistributed net income retained for investment and employment in the corporation's business is not so employed or is not required for the reasonable needs of the business.

175.—NO SPECIFIC EXEMPTION.

A corporation does not enjoy the specific exemption granted an individual. However small its net income, it must pay a tax thereon, with the exception that income from Government, State, municipal and certain other bonds, and the value of property acquired by gift, bequest or descent is not taxable.

176.—EVERY CORPORATION.

"Every Corporation" must pay the tax, says the law, with the exception of those specifically enumerated as exempt from tax. [See Chapter on "Corporations Exempt."]

The word "every" must be taken at its literal meaning.

177.—WITHOUT INCOME MUST FILE RETURN.

Every corporation, unless specifically exempted because of its character, must file a return, whatever the amount of its net income and **even though it have no net income.** This means that many corporations operating at a loss must file returns and in such returns set forth all items of gross income and deductions. Whatever the result of the year's operations—profit or loss—the return must be filed just the same, although, of course, where there is no net income shown there is no assessment of tax.

178.—SUBSIDIARY CORPORATION.

A subsidiary corporation, maintaining an incorporated organization of its own, is required to file a return. The regulations of the Treasury Department take no account of its relation to a parent corporation. If a principal corporation maintains several subsidiary corporations, each is regarded as a separate and distinct entity and **each must file a return.** This requirement is enforced even though the purpose of maintaining the subsidiaries be merely the protection of brands or trade names, and though the parent corporation own all of the stock of the subsidiary corporations. The return filed by each subsidiary must be complete in every detail.

The subsidiary corporation should file its return with the Collector of Internal Revenue in whose district it has its principal accounting offices even though such district may not be the same as that in which the parent corporation is required to file return.

179.—CORPORATION NOT COMPLETELY ORGANIZED.

A corporation which has not succeeded in completing its organization, and has transacted no business and had no income, is not required to file a return. This condition is found in the case of a corporation which has applied for but not received its charter or which, after the receipt of its charter, has not taken the other steps essential to the perfection of its corporate organization. The uncompleted status of the corporation should, however, be explained in writing to the Collector of Internal Revenue; otherwise he will demand a return, having received information from State authorities of the application for a charter.

180.—NEW CORPORATION.

Even though a corporation has not been in existence a full year, it must file a return. This has reference to new corporations. The return should cover that portion of the year during which it was engaged in business or was in receipt of an income. Such corporation may file upon the basis of either the calendar or its own fiscal year [as is explained in the case of all corporations in special instructions regarding "Fiscal Year."]

181.—DISSOLVED CORPORATION.

If a corporation dissolves during a tax year, it must still file a return for that part of the tax year during which it was in existence. This return may be filed either at the time of dissolution or liquidation, or at the customary time for filing returns—on or before March 1st.

182.—RETURN THOUGH NO BUSINESS.

When organization has been completed a corporation must file a return for the year of its organization, whether it has actually engaged in business or not. And, as in the case of all corporations, this return may be on the basis of either the calendar year or the corporation's own fiscal year. Generally such a return is not much more than a "return in blank;" however, the Treasury Department requires that it be filed.

183.—CLOSE CORPORATION.

The so-called close corporation—the family convenience—organized to hold property, is required to file return as any other corporation. The primary purpose of this close corporation may be merely protection of property interests rather than profit-making from engaging in business, within the commonly accepted meaning of the phrase "engaging in business;" nevertheless, it is required to file return and pay tax when any tax is found to be due. As hereinbefore explained, neither profit-making nor engaging in business is the test of liability to file an income tax return.

184.—HOLDING COMPANY.

A corporation which is nothing more than a holding company, organized and maintained to hold a stock interest in another corporation, is required to file a return. As far as the tax rate imposed by the old law (Act of September 8, 1916) is concerned, it is also required to pay tax on its entire net income. That law allows a corporation no credit for income received in the form of dividends on the stock of another corporation. It has, therefore, often happened that an operating company, paying income tax on entire net income, has turned that net income over to a holding company as a dividend. The holding company has also been required to file return and report as total gross income the amount of the dividend, provided it has had no other income, and against this gross income it has had few, if any, deductions that it could claim, all the expenses of the business giving rise to the income having been charged off in the return of the operating company. In return, the holding company has distributed to its own stockholders the income from the business, but in passing from the business to the actual owners that income has borne the corporation income tax twice—once in the assessment against the operating company and again in the assessment against the holding company.

This will continue as far as the imposition of the 2 per cent tax of the old law is concerned; but credit will be given a corporation for

dividends received from another corporation in the computation for the 4 per cent tax imposed by the new law.

185.—LIMITED PARTNERSHIP.

A limited partnership has been held by the Treasury Department to be a corporation within the meaning of the Income Tax law. It must make return under the regulations applicable to corporations and must pay tax when tax is found to be due. The limited partnership is regarded as an **"association"** subject to tax under that provision of the law imposing the tax upon the net income of "every corporation, joint-stock company, or association, no matter how created or organized."

An individual, receiving profits from a limited partnership should treat such profits the same as dividends from a corporation.

186.—PRIVATE BANKS LIABLE.

A private bank which maintains a corporate organization, elects officers and distributes its earnings according to the amount of capital invested by its members or owners, is under the full income-tax liability of a corporation. It must make return. Only when it can be shown that a private bank is owned by one man and is not an association within the meaning of the Income Tax law, can release from liability to file return be granted.

187.—CHANGE OF NAME.

While each new corporation becomes liable under the law, the Treasury Department has held that a mere change in name does not constitute a new corporation. If the business is continued, without change in organization or operation other than the change in name, return should be made for the entire year in the name of the corporation at the end of the tax year and with a notation on the return regarding the change of name. However, when a new corporation is organized to take over the property of an old corporation, each corporation is required to make a return for that period of the year during which it had charge of the business.

188.—RECEIVER MUST MAKE RETURN.

Subdivision C of Section 10 of the Act of September 8, 1916, as amended, transfers to receivers, trustees in bankruptcy, or assignees operating the property or business of corporations, all the obligations imposed upon the corporations themselves. They must file returns and pay the tax.

On this point a sample ruling of the Treasury Department in an official letter is so specific that it is deemed advisable to quote it in full. The ruling is as follows:

> The fact that the business and property of a corporation are temporarily in the hands of a receiver does not appear to be material and does not, in the opinion of this office, relieve such income from liability to the tax, for the reason that, under such circumstances, the corporation is none the less the beneficiary of the income arising and accruing. The ordinary functions, privileges and benefits of the corporation may be in suspense during the period its affairs are in charge of the receiver, but the income is none the less the income of the corporation, and if there is a net income it is clearly taxable, and the custodian of such income is liable to the tax assessable thereon. Therefore, replying to your inquiries you are informed:
>
> (1) That the receiver of the property of a railway company is liable for the income tax on the net income derived by him for the operation of the property, even though such net income is used by the receiver, under orders of the court, in the payment of the indebtedness of the railway company incurred in part prior to and in part during the year in which the net income was earned.
>
> (2) The receiver is liable for the income tax on the net income arising and accruing during his incumbency, even though such net income is retained by him pending orders of the court as to its disposition. The fact that the outstanding current liabilities, incurred in part prior to and in part during the year in which the income was earned, are greater or less than the amount of the net income, is immaterial. If the earnings of the year are in excess of expenses incurred in creating the income, so that net income arises or accrues, that net income is taxable, and the receiver is liable for the tax imposed thereon.
>
> (3) The receiver is liable for the income tax assessable upon the net income arising and accruing during his incumbency, even though, under orders of the court, such net income is turned over to the railway company, the outstanding liabilities of the railway company having been satisfied.
>
> (4) The receiver is liable for the income tax assessable upon the net income arising and accruing during his incumbency, even though such net income, under orders of the court, is used in the payment of interest on bonds of the railway company, such interest having accrued during the year in which the income was earned and being in excess of the amount which the railway company, under the income tax law, would be permitted to deduct from gross income in arriving at its net income, were it in charge of the property and making the return. In other words, for the purpose of the income tax, a receiver in charge of the property and business of a corporation must make a return of annual net income as of and for the corporation, applying the same rules, both as to income and deductions, as the corporation would apply were it making the return. For the purpose of the income tax, the receiver of corporate property acts for and in the capacity of the officers of the corporation.
>
> (5) From the foregoing you will observe that, in the opinion of this office, a receiver in charge of the business and property of a corporation is liable for the tax assessable upon the entire net income arising and accruing and of which the corporation is the beneficiary.

189.—FOREIGN CORPORATION.

A foreign corporation is liable to tax only upon net income received from **"all sources within the United States."** However, some

specific definitions have been provided by the Treasury Department with respect to income from within the United States. The buying and selling of a product in this country through an agency or branch office, or the sending of a representative to this country to solicit business is held to bring the foreign corporation within the meaning of the Income Tax law.

Also the statute provides that interest on bonds or notes of residents of the United States, and dividends from domestic corporations shall be regarded as income from sources within the United States.

The method of ascertaining the income-tax liability of a foreign steamship company carrying freight and passengers out of this country is clearly set forth by the Treasury Department in the following ruling:

> "The returns made by such corporations, for the purpose of the income tax, should include as gross income the total receipts of all outgoing business, whether freight or passengers. With the gross income thus ascertained, the ratio existing between it and the gross income from all ports, both within and without the United States, should be determined as a basis upon which allowable deductions may be computed, the principle being that allowable deductions shall be computed upon a basis which recognizes that the income arising and accruing from business done in and from this country shall bear its share, and no more, of expense, incident to the earnings or creation of such income, in the ratio that the gross income arising in and from this country bears to the entire gross income arising from business done both within and without this country. In other words, the net income of a foreign steamship company doing business in or from this country, for the purpose of the income tax assessable and payable to the United States, will be ascertained by deducting from the gross receipts from outgoing business such a portion of the aggregate expenses, losses, etc., as such receipts bear to the aggregate receipts from all ports, except that the interest deduction, after being likewise apportioned, shall be subject to the limitation fixed by the law." (See instructions relative to Interest Deduction.)

The return of a foreign corporation should be made by its principal branch in the United States. If a foreign corporation has several branches of equal importance, it should designate one of them as its principal branch and at the same time name the proper officers to make its return. Notice of this designation should be filed with the

Collector of Internal Revenue of the district in which the principal branch has its place of business.

A foreign corporation has the same right as a domestic corporation to make return upon the basis of its own fiscal year instead of the calendar year, by complying with the regulations relating to fiscal year returns.

A foreign corporation also can claim exemption from the income tax if it comes within the classes specifically enumerated as exempt.

And, as in the case of a domestic corporation, so in the case of a foreign corporation, receivers, trustees in bankruptcy, or assignees, operating the property or conducting the business, are required to make return for the corporation.

CHAPTER XIV

THE INCOME TAX

CORPORATIONS EXEMPT

Certain corporations are specifically exempted by the law from payment of income tax. If exempt, a corporation is not required to file the return of annual net income that provides the basis of assessment of income tax.

It does not follow from exemption from tax, however, that a corporation of exempt character does not have to give the Department such reports of information, or otherwise, from the source, as may be called for by the Commissioner of Internal Revenue.

The question of exemption is one, however, that has caused a great deal of trouble and certain difficulties experienced in administration will, for that reason, be emphasized.

190.—EXEMPT CLASSES.

If a corporation belongs to one of the following classes it is not subject to the tax:

1. Labor, agricultural or horticultural organization.

2. Mutual savings bank not having a capital stock represented by shares.

3. Fraternal beneficiary society, order, or association, operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association or their dependents.

4. Domestic building and loan association and co-operative banks without capital stock organized and operated for mutual purposes and without profit.

5. Cemetery company owned and operated exclusively for the benefit of its members.

6. Corporation or association organized and operated exclusively for religious, charitable, scientific, or educational purposes, no part of the net income of which inures to the benefit of any private stockholder or individual.

7. Business league, chamber of commerce, or board of trade, not organized for profit and no part of the net income of which inures to the benefit of any private stockholder or individual.

8. Civic league or organization not organized for profit but operated exclusively for the promotion of social welfare.

9. Club organized and operated exclusively for pleasure, recreation and other non-profitable purposes, no part of the net income of which inures to the benefit of any private stockholder or individual.

10. Farmers' or other mutual hail, cyclone, or fire insurance company, mutual ditch or irrigation company, mutual or co-operative telephone company, or like organization of a purely local character, the income of which consists solely of assessments, dues and fees collected from members for the sole purpose of meeting its expenses.

11. Farmers', fruit-growers', or like association, organized and operated as a sales agent for the purpose of marketing the products of its members and turning back to them the proceeds of the sales, less the necessary selling expenses, on the basis of the quantity of produce furnished by them.

12. Corporation or association organized for the exclusive purpose of holding title to property, collecting income therefrom and turning over the entire amount thereof, less expenses, to an organization which itself is exempt from income tax.

13. Federal land banks and national farm-loan associations, as provided in Section 26 of the Federal Farm Loan Act of July 17, 1916.

14. Joint stock land banks as to income derived from bonds or debentures of other joint stock banks or any Federal land bank belonging to such joint stock land bank.

191.—MUST BE SURE OF EXEMPT STATUS.

It will not do for the responsible officers of a corporation to conclude that their corporation is exempt unless they can classify it

strictly and precisely according to the specific definitions outlined above. If a corporation is merely similar in character to one of an exempt class, it is not necessarily exempt. The Treasury Department, in passing upon the question of exemption, has held to the exact phraseology of the law. Inquiry should, therefore, be made and the facts stated, that there may be no trouble.

192.—PROFIT-MAKING NOT THE TEST.

A corporation is not exempt merely because it is primarily not organized and operated for profit. Organization for profit is not, therefore, in general the test of exemption, even though it should be applied with respect to certain of the exempt classes as enumerated hereinbefore. Under the law any corporation, **no matter how created or organized,** is subject to tax unless it comes within the classes specifically enumerated. So the test of exemption becomes one of applying one of the definitions in the statute to the corporation in question without departing in any way from the language of the law and without guessing as to what might have been the unexpressed intent of Congress.

193.—SHOULD PROVE EXEMPT STATUS.

Even though the officers of a corporation are themselves convinced that the corporation is exempt, they should file a statement of the character of the corporation with the Collector of Internal Revenue. This statement should be in affidavit form, and should be accompanied by evidence in support of the claim made. Material evidence would be a copy of the corporation's charter and By-laws. This, however, need be done only once. In the case of a new corporation it should be done within the time the corporation would be required to file a return of income were it not exempt. After he has considered the evidence, it becomes the duty of the Collector to notify the corporation in writing whether it is exempt or must pay tax. If such notification is not received, the matter should be called to the attention of the Collector. As just explained, however, this proof need be offered only once; it is not necessary for the corporation to claim exemption each year. Having once established its exempt status, it is free provided its character remain the same.

194.—EXEMPT FOREIGN CORPORATIONS.

Any foreign corporation with income from sources within the United States has the same rights with respect to exemption as a domestic corporation. It should follow exactly the course just outlined.

195.—AGRICULTURAL ASSOCIATIONS.

Time and again exemption from tax has been claimed by corporations engaged in agriculture. This has always been due to a misunderstanding of the law. Those agricultural and horticultural associations enumerated as exempt have been held to be such associations as fairs or public expositions, or like organizations, not themselves engaged in agricultural or horticultural pursuits but conducted for the purpose of encouraging progress by the award of prizes and premiums. In other words, the agricultural or horticultural association, to be entitled to exemption, must be public in character.

196.—BUILDING AND LOAN ASSOCIATIONS (DOMESTIC)

Among the corporations enumerated as exempt from tax are domestic building and loan associations. The Treasury Department has held a **domestic building and loan association** to be "one organized under and pursuant to the laws of the United States, or of a State or Territory thereof, or under the laws applicable to Alaska or the District of Columbia." But the Department has also gone farther and insisted that the question of exemption from tax also depends on mutuality in operation and the distribution of profits and benefits. Therefore, to be entitled to exemption, under the Department ruling, an association must not only be "domestic" but must be so organized and operated that all the profits and benefits provided for in the articles of association and by-laws are ratably distributed among all the members "regardless of the kind of stock held, according to the amount of money they have on deposit." And so it is held that the issuance of different classes of stock upon which different rates of interest or dividends are guaranteed or paid deprives an association of the right of exemption.

197.—CEMETERY COMPANIES.

As in the case of corporations engaged in agriculture so corporations engaged in the operation of cemeteries for profit have claimed exemption because of a misunderstanding of the law. Exemption, in this respect, is strictly limited to cemetery companies organized and operated exclusively for the mutual benefit of their members. A cemetery company must, therefore, be **mutual** in character.

198.—SOCIAL CLUBS.

As a rule, clubs are exempt. However, there are many incorporated business enterprises, styled clubs, that are not entitled to exemption. The test is the plain language of the law. The club must

be operated exclusively for pleasure, recreation or other non-profitable purpose and no part of its net income can inure to the benefit of any private stockholder, individual or member. Moreover, it should submit its case to the Collector of Internal Revenue in the form of affidavit and get his opinion of its status.

199.—SOCIETY UNDER LODGE SYSTEM.

The exemption granted a "fraternal beneficiary society, order, or association, operating under the lodge system" is intended, according to the Treasury Department ruling, for a society or association "organized under a charter, with properly appointed or elected officers, with an adopted ritual or ceremonial, holding meetings at stated intervals, and supported by fees, dues, or assessments."

CHAPTER XV

THE INCOME TAX

GROSS INCOME OF CORPORATIONS

The Income Tax law requires that **gross income** be stated in full by a corporation. The amount derived from each source must be stated and the aggregate ascertained. Then from this total of gross income may be subtracted the total of deductions allowable, leaving what, under the statute, is the **net income.** It is, therefore, essential primarily that a corporation be given to understand what is expected of it in the statement of its **gross income.**

Certain rules have been made by the Treasury Department for determining the gross income of a corporation; at times these rules have been adapted to the exigencies of certain cases, so from an experience in enforcing them and in handling the many special cases that have arisen a general outline of the requirements of the Department can be given here. However, cases requiring special attention will continue to arise. It is manifestly impossible to lay down any set of rules to cover the administration of a law that comprehends in its effect almost every conceivable business relation and condition.

Briefly are outlined the requirements of law and regulation with special reference to certain well-defined classes of corporations. Always, however, the taxpayer, whether individual or corporation, should bear in mind that income in the form of interest on United States bonds (within the limit with respect to those issued after Sept. 1, 1917) and on State, county, municipal, school and special assessment district bonds is exempt from tax and is not to be included in any return of income.

200.—BANKING CORPORATION.

The gross income of a banking corporation consists of the total revenue from the operation of the actual business of banking and

from all other activities of the corporation. In fact gains and profits from every source, as shown by the books of the corporation, or bank, (excepting interest on the tax-free bonds hereinbefore referred to) must be included in the return of the corporation for the calendar year, or its own fiscal year.

Recovery on a Note.

In the case of a bank the Treasury Department has ruled that where a bad account, represented, for instance, by defaulted paper, has been charged off and subsequently the amount has been recovered, the amount recovered must be included as income for the year in which recovered. Of course, if the amount had been charged off to profit and loss within the period beginning January 1, 1909, (the incidence of the old corporation excise tax) and the corporation had had the benefit of a deduction on account of "bad debts," it would naturally follow that the recovery of the money represented income to be included in a return. The Department holds, however, that even though the amount was charged off and disappeared from the assets of the bank prior to January 1, 1909, the recovery of the money represents income for the year in which recovered. Neither the date at which it was charged off nor the fact that the corporation did not have the benefit of a deduction of it, as a bad debt, for income tax purposes, affects its character as income for the year in which recovered, in the opinion of the Department.

A case in point would be as follows: A bank in the year 1908 held the note of a bankrupt for $20,000. As collection was out of the question the amount was regarded as irrevocably gone and was charged off as a bad debt. In the year 1917, the maker of the note, having rehabilitated his affairs, paid the note as an obligation of honor. In such circumstances the bank must include the amount of the recovery as income for the year 1917.

Federal Reserve Dividends.

Income from or dividends on the stock of Federal Reserve Banks, received by member banks, is exempt from income tax and need not be included by member banks in their returns for income tax purposes, according to a ruling in a letter to the Governor of the Federal Reserve Board from the Commissioner of Internal Revenue on March 9, 1916. The substance of the Commissioner's ruling is as follows:

> This office has decided that the income derived from, or dividends received on, the stock of Federal Reserve Banks is exempt from the income tax. In other words, it is held that the exemption provided for in the Federal Reserve Act attaches to and follows the dividends into the

hands of member banks holding the Federal Reserve Bank stock. Member banks will therefore be permitted to exclude from their gross income, for the purpose of the income tax, the dividends received on such stock.

201.—CONTRACTING CORPORATION.

Special provision has been found necessary in order to enable a corporation engaged in the contracting business to ascertain its gross income equitably, for the purpose of the income tax. Consequently, the Treasury Department has ruled that gross income may be arrived at upon the basis of completed work—according to work finished and paid for during the year for which the return is made. This method is not imposed upon all contractors, but experience has shown that it is best in the case of a concern which has uncompleted contracts that run for periods of several years. When this method is employed, the deductions of the contracting corporation are limited to expenses in connection with the completed jobs from which income is reported.

202.—INSURANCE CORPORATIONS.

Corporations engaged in the insurance business have been given special instructions to fit the varying conditions with respect to different kinds of insurance and peculiar, in each instance, to the operations of the corporation along its own line of activity.

In the first place, and in general, of course, the gross income of an insurance company consists of its total revenue from the operation of its business and of gains or profits from all other sources, as shown by its books, within the year, calendar or fiscal, for which the return is made. But one rule without variation or elaboration cannot be made to fit all classes of the insurance business, so special instructions are necessary.

Life Insurance.

A **life insurance company** is allowed to omit from gross income such portion of any actual premium received from an individual policyholder as shall have been paid back or credited to the policyholder or treated as an abatement of his premium. Deferred dividends, so-called in insurance parlance, payable at a stated period, can also be omitted from gross income in so far as they represent a portion of any actual premium received, such omission to be with respect to the year in which paid back, credited to the policyholder, or applied as an abatement of premium. In the case of dividends credited or apportioned annually to the policyholder, only the aggregate amount actually credited or apportioned during the premium-paying period,

and not any accretion thereto, can be omitted. In the case of whole-life or five-year distribution policies, deferred dividends may be omitted from gross income only to the extent that they are paid back, or credited to the insured, or used as an abatement of his annual premiums.

Mutual Fire Insurance.

A **mutual fire insurance** company, the members of which are required to make premium deposits to provide for losses and expenses, can omit from gross income any portion of the premium deposits returned to the members or policyholders, but **must include,** for income tax, all income received from all other sources plus such portions of the premium deposits as are retained by the company for purposes other than the payment of losses, expenses and for reinsurance reserves. Thus, if a mutual fire insurance company retains out of moneys received on account of assessments an amount in excess of the losses, expenses, and reinsurance reserve of any particular year, such excess, plus any amounts received as interest, dividends, or from any other source, is regarded as **net income,** upon which tax can be assessed In other words, in the case of such an insurance company the result obtained by following the instructions of the Treasury Department is **net income,** rather than **gross income.**

Mutual Employers' Liability Insurance.

A mutual employers' liability insurance company should follow instructions given the mutual fire insurance company.

Mutual Workmen's Compensation Ins.

A mutual workmen's compensation insurance company also should follow instructions given the mutual fire insurance company.

Mutual Casualty Insurance.

A mutual casualty insurance company should, likewise, follow instructions given the mutual fire insurance company.

Mutual Marine Insurance.

A mutual marine insurance company is required to include in its return the **gross premiums** collected, but is allowed in its return to claim deductions for amounts repaid to policyholders on account of premiums previously paid by them and any interest paid upon such amounts between the time they are ascertained and the time they are paid.

203.—RELEASED INSURANCE RESERVES.

An insurance corporation, required under State laws to maintain certain specified reserves is allowed under the Federal Income Tax law to deduct from the gross income of any year the net additions required by law to be made to reserves during that year; but the corporation must return for the purpose of the income tax any amount of released reserve, as such release may occur from time to time.

204.—MISCELLANEOUS CORPORATIONS.

As already explained, the income tax law contemplates that a return shall include income from all sources, except from specifically exempted sources, and the corporation is expected to comply with that general purpose of the statute in the lack of special instructions which it may regard as necessary to fit its own affairs. In short, the general requirement should be borne in mind that the gross income of a corporation consists of the total revenue derived from the operation of its business and property, together with all amounts of income from other sources, as shown by its books of account, except income from specifically exempted sources.

205.—PROCEEDS FROM SALE OF STOCK.

The proceeds received by a corporation from the sale and issue of its capital stock are not income. On the other hand, such proceeds constitute capital of the corporation and should not be included in a statement of gross income. Likewise, any amount received in the form of an assessment on stock is not income to be returned for tax by the corporation. Such an amount is held to represent an additional investment in the stock of the corporation and the transaction is purely capital with respect to both the corporation and the stockholder.

Above or Below Par.

And it makes no difference whether the stock, as originally, issued, is sold above or below its par value. Neither the premium nor the discount, with respect to par value, has anything to do with the income of the corporation for income tax purposes. The amount received for the stock is strictly capital to the corporation.

206.—RECOVERIES ON BAD DEBTS.

With respect to the treatment of any amount recovered on a debt charged off as worthless, the taxpayer should follow the general ruling explained in connection with the gross income of a bank. [See paragraph headed **"Banking Corporation."**]

207.—SINKING FUND EARNINGS.

By definite decision the Department has held that in cases wherein corporations set aside and place in a sinking fund under the control of trustees their own bonds or the bonds of other corporations which they may own, the fund thus set aside is an asset of the corporation, and, in the event of any increment to that fund as a result of investments, such increment is income to the corporation and must be included in its return.

If the trustees, in such a case, have invested the amount of the sinking fund reserve or any part of it in the bonds of the corporation for which they act, a situation has been created which calls for careful treatment. The Department has held that the corporation would be allowed to deduct in its return any interest paid to the trustees on its own bonds (provided the amount of the interest thus paid did not exceed the limit fixed by law) but that at the same time the corporation would be required to include such amount of interest paid the trustees in accounting for income represented by the earnings of the sinking fund.

208.—ROYALTIES AND PATENT RIGHTS.

The instructions applicable to the income of individuals with respect to royalties and patent rights, or copyrights, apply also to the income of corporations. [Consult the instructions given under appropriate headings in connection with income of individuals.]

209.—ROYALTIES FROM MINES OR WELLS.

Royalties from mines or from oil or gas wells received by a lessor corporation from a lessee operating concern, obviously represent returnable income to the lessor corporation.

210.—EXCHANGE OF CAPITAL STOCK ON REORGANIZATION OF CORPORATIONS.

As hereinbefore explained, income received in cash, or the equivalent of cash, is subject to tax; and a corporation is required to return for tax its income, gains and profits from all sources except certain specifically exempted income.

The Treasury Department has defined "Profit" as "difference between the selling price and the cost where the selling price is more than the cost." This definition would have to be modified, however, to substitute **"fair market price or value as of March 1, 1913"** for "cost" in the case of property acquired prior to March 1, 1913.

All of which bears upon the Department's position with respect to the exchange of capital stock or securities by which corporations are reorganized within themselves, or by which two or more corporations are consolidated or merged into one general management and control.

On this point the Department has at least once changed its position, but its present ruling may be taken from the following official letter issued by the Commissioner of Internal Revenue on September 9, 1916:

> The present holding of this office is that in all cases wherein a corporation sells and transfers its assets to another corporation, the amount received by the selling corporation in excess of the cost of the property sold will be considered income to such selling corporation. [In the case of acquisition of the property by the selling corporation prior to March 1, 1913, the fair market price or value of the property as of that date must be considered instead of cost in determining excess, or gain.]
>
> If the shares of stock received by the selling corporation are distributed by it to its stockholders, the amount so distributed in excess of the stock held by them in the original corporation will be considered income to such stockholders and, for the purpose of the super-tax, should be returned by them. * * * *
>
> The selling corporation being taxable on the excess of the stock received over the cost of the assets sold [or over fair market price or value as of March 1, 1913, in the case of assets acquired prior to that date,] the individuals receiving the excess in the form of stock of the purchasing company will not be required to return their respective shares of such excess for the purpose of the normal tax.

However, there may be a sale of its assets by a corporation to another corporation for stock, share for share, of like par value and with the same assets supporting the stock of the new vendee corporation as fixed the true value of the stock of the old vendor corporation. A case in point would be as follows:

A corporation with an authorized capital stock of $500,000, had in 1912 acquired property representing an investment of its entire issued capital stock of $350,000. For good reason it is decided to organize a new corporation, also with an authorized capital stock of $500,000, such new corporation to take over the investment of the old corporation, in consideration of the issue of $350,000 of its capital stock, such stock of the new corporation to be distributed among the stockholders of the old corporation, according to their individual interests in the old corporation. After the transfer of assets and the completion of the transaction the old corporation would be dissolved.

In such a case the Treasury Department has held that, the shares of stock authorized and issued being the same as to both corporations, and there being no consideration to the old corporation for its assets, other than the $350,000 par value of the new corporation's stock, an

amount exactly equal to the par value of the old company's stock outstanding, no profit subject to tax would accrue to the old corporation. Such an exchange of stock would not constitute a stock dividend and, being on the basis of issuance, share for share, of like par value, would not result in any taxable income to the stockholders of the old corporation. The stock, both authorized and issued, being in both cases of like par value and being predicated upon exactly the same assets, the transaction would result in no gains, profits or income to either the old corporation or its stockholders.

But if subsequently the stockholders of the new corporation (who prior to the transaction were the stockholders of the old corporation) should sell their stock in the new corporation, they would be required to return for tax any amount received for the stock of the new corporation in excess of the cost of the same number of shares of stock of the old corporation (if the stock of the old corporation was acquired on or after March 1, 1913), or in excess of the fair market price or value of the stock of the old corporation as of March 1, 1913, (if the stock of the old corporation was acquired prior to March 1, 1913.) In other words, the investment in such a case would be regarded as having its beginning in the acquisition of the stock of the old corporation.

211.—GOOD WILL.

While the Treasury Department has held that the element of "Good will" is so intangible as not to enter into the calculation of the value of a corporation's assets, and as subject to neither depreciation nor appreciation, still it may be a considerable factor in the case of a sale of assets by one corporation to another, effected by the selling corporation taking for distribution among its stockholders stock of the purchasing corporation. In a case where the assets of the selling corporation were acquired prior to March 1, 1913, the value of the assets of that date must be ascertained. Experience has shown that the most nearly equitable computation in such circumstances is based upon the fair market price or value of the selling corporation's stock on March 1, 1913, and certainly in the determination of such price or value, in many instances, good will (business standing) was a factor even though it was an intangible asset at the time.

212.—COMPROMISE OF INDEBTEDNESS.

The compromise of indebtedness creates income to be returned for tax, according to the ruling of the Department. In this respect

the following official letter issued by the Commissioner of Internal Revenue on July 10, 1915, is self-explanatory:

> This office is in receipt of your letter of the 30th ultimo in which you submit for ruling the following proposition:
>
> "A company which has been unable to pay any interest on its bonded indebtedness for some years proposes to settle that indebtedness, the creditors to reduce the face of the bonds by $100,000 as an inducement for the raising of $100,000 in cash.
>
> "By this process the apparent financial condition of the debtor company is improved by $100,000, not through any earnings but by effecting a settlement with its creditors by which $200,000 of its bonds are cancelled at a cost to it of $100,000 in cash, namely at 50 cents on the dollar."
>
> In reply to your inquiry as to whether such a compromise of indebtedness is taxable as income, you are informed that while in fact the earnings of the corporation are in no wise increased by this compromise, the liabilities are reduced and to that extent the corporation gains in its net worth.
>
> In somewhat similar cases to this, in which the creditor has forgiven the debt of the debtor, this office has held that the amount of the debt forgiven constitutes income. In this particular case, in the opinion of this office, the difference between the amount realized by the corporation when the bonds were sold and the amount which it now is required to pay upon the redemption of the same, constitutes income, which income may be prorated over the period elapsing between the date of the bond issue and the date of their payment, and that portion of such income apportioned to the years subsequent to January 1, 1909, will be returned as taxable income for the year in which the bonds are redeemed.

213.—INTEREST ON BONDS WITH TAX-FREE GUARANTY.

A corporation which owns bonds containing a guaranty that the interest paid on them shall be free of tax to the holder is not relieved of liability to include such interest in its own return. The law does not provide for transfer of tax liability to the corporation which has issued the bonds. In other words, the Government does not recognize the guaranty in the bond but insists that the corporation receiving the interest shall include the amount in its return the same as any other amount of interest received.

It is well, therefore, for any corporation owning such bonds and receiving interest on them to realize that, absolutely without regard to the covenant in the bond, the full amount of the interest must be included in a return of gross income. Any adjustment, by which the holder of the bonds may seek the benefit of the covenant, must be between the holder of the bonds and the corporation which has issued them.

214.—PROFIT FROM SALE OF CAPITAL ASSETS.

The entire profit or gain realized from the sale or other disposition of capital assets must be included in a return of income. This has reference to all property, both real and personal. With respect to

the methods of ascertaining the gain from a sale or other disposition of real property and that from a sale or other disposition of personal property, however, there are some points, not exactly of difference, but rather of peculiar application to one or the other kind of property.

[See instructions beginning with paragraph **"Sale of Property"** in instructions to individuals.]

Acquired on or After Mar. 1, 1913.

With respect to all property, both real and personal, acquired on or after March 1, 1913, the gain to be returned is the difference between the selling price and cost where the selling price is more than the cost.

Acquired Prior to Mar. 1, 1913.

With respect to all property, both real and personal, acquired prior to March 1, 1913, the gain to be returned is the difference between the selling price and the fair market price or value as of March 1, 1913, where the selling price is more than the fair market price or value as of that date.

Cost of Real Estate.

Cost, in the case of real estate, may include other items than the purchase price. To the purchase price may be added the expense incident to purchase and the cost of improvements, if any. In circumstances where it can be shown that the corporation has not deducted carrying charges from income of the years in which paid, expenditures for interest, taxes, insurance, etc., may also be considered in arriving at cost. Among these latter charges may be mentioned those expenses referred to in the law as "taxes assessed against local benefits"—the assessments for local betterments that can not be deducted by either an individual or a corporation in the preparation of a return of income. Such charges can, however, be properly capitalized in ascertaining the cost of property in order that gain resulting from a sale or other disposition of the property may be determined. These charges have been referred to before; among them are local sidewalk, street improvement and sewer construction assessments, as well as assessments for the building of irrigation and drainage works.

Fair Market Value of Real Estate.

The fair market price or value of real estate as of March 1, 1913, would, obviously, be ascertained, in a case of ownership by a corporation, exactly as when owned by an individual. It is, therefore, sug-

gested that the taxpayer refer to instructions given individuals and follow the most suitable and most nearly accurate of the methods therein outlined.

Cost or Value of Securities.

The cost of such personal property as stocks and bonds, acquired on or after March 1, 1913, does not seem to require definition. However, difficulty is sometimes experienced in ascertaining the fair market price or value as of March 1, 1913, as a basis for computing gain from the sale of securities acquired prior to that date. In the case of securities traded in on the exchange on March 1, 1913, information as to the fair market price or value is readily at hand, but in the case of securities not then on the open market the determining data must be sought elsewhere—from private sales, where possible, or, if there were no such sales, from the value of assets on March 1, 1913, considered in relation to the value of assets on the date of disposition of the securities.

When Paid for in Stock.

When property has been acquired by a corporation in exchange for its capital stock, with the nominal par value of the stock greatly in excess of the actual value of the property acquired, the amount of gain represented by a subsequent disposition of the property must be ascertained by disregarding the par value of the stock issued in payment for it and by determining the actual value of the property at the time of acquisition, the difference between the selling price and such actual value at the time of acquisition to be returned by the corporation for the purpose of the tax.

215.—IN MORE THAN ONE BUSINESS.

A corporation engaged in more than one kind of business must ascertain its gross income from all sources and include the total in its return. Only interest on the bonds of the United States or its possessions, and of a State or political subdivision of a State, or on Federal Farm Loan bonds is exempt and can be excluded in making the return for tax.

216.—CORPORATION OPERATING LEASED PROPERTY.

If a corporation has leased its properties to another corporation in consideration of a rental which is the equivalent of a certain rate of dividends on the outstanding capital stock and the interest on the bonded indebtedness of the lessor corporation,

and if such rental is paid directly by the lessee corporation to the stock and bond holders of the lessor corporation, a problem is created which should be solved as follows: The lessor corporation should return the amount of the rental for tax and the stock and bond holders should account for the amounts received by them as dividends from the lessor corporation. The position of the Department in this respect is explained in Treasury Decision 2090 as follows:

> Payments measured by a fixed percentage on the stock of a railroad corporation whose lines are leased by another railroad corporation and which rent is payable by the lessee directly to the stockholders of the lessor corporation, have under the income tax law with respect to the corporation paying such sums, the status of a rental payment.
>
> In such cases there are two corporations involved, the lessor and the lessee—one the rent payer and the other the rent receiver. To the lessee rental payments are an expense of operation; to the lessor the rentals are an income.
>
> A contract which provides that the rentals shall be paid to a third party, not a party to the contract, does not change the character of the payment, nor relieve the lessor from liability to tax on the rental which the lessee pays to it or to such third party. The income of the third party, the stockholder, is dividends on the stock which he holds in the lessor company. Dividends cannot be paid unless the lessor has an income out of which to pay them. Hence the lessor company is required under the law to return as income the rentals which the lessee is required to pay. In paying direct to the stockholders the lessee is acting as agent of the lessor, and the amounts received by the stockholders are, in effect and in fact, dividends received out of the earnings of the lessor.

CHAPTER XVI

THE INCOME TAX

DEDUCTIONS ALLOWED CORPORATIONS

A.—EXPENSES

217.—OPERATING COSTS.

In its return of income a corporation is allowed to deduct from gross income "all the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties." So reads the law, and in great detail various items of expense have been considered and passed upon in the administration of the statute. Some expenditures are deducted under other headings than that of "Expenses," as will be explained, but, if legitimately chargeable against gross income, they serve to reduce the amount of net income subject to tax.

218.—BETTERMENTS AND ADDITIONS.

Expenditures for betterments and additions which represent a permanent improvement of the property are not allowable deductions. They are regarded as constituting an increase of capital investment and not as an expense chargeable against gross income for any year in the computation of income tax liability.

219.—RENTAL EXPENSE.

The law specifically provides that the deduction on account of expense shall include "rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity." This payment may be in cash or the equivalent of cash. (See paragraph on **"Buildings on Leased Ground,"** also paragraph on "Corporation Operating Leased Property.")

220.—COST OF LABOR AND PERSONAL SERVICES.

The entire cost of labor and personal services is an expense of operation and maintenance. In connection with such payments there have arisen, however, a number of questions to which the special references below should be made.

221.—SALARIES OF EMPLOYEES.

Salaries actually paid to the officers and employees of a corporation, if they represent what the Treasury Department refers to as "fair and reasonable compensation," are a deductible expense. Just what the Department means by "fair and reasonable compensation" is not exactly known, but, presumably, the limitation is imposed to prevent the charging of fictitious salaries for excessive amounts against the gross income of a corporation for the purpose of reducing the corporation's income tax liability. Salaries, to be a proper item of expense of operation should not, under the present ruling, depend upon the profits earned by the corporation.

222.—COMMISSIONS—IN CASH OR STOCK.

All commissions paid salesmen are legitimately deductible, as an expense of doing business. Even when paid in stock, a commission may be deducted, if so charged on the books of the corporation, at the actual value of the stock given the salesman.

223.—SALARIES TO ABSENT SOLDIERS.

If a corporation continues to pay an employee his salary, in whole or in part, during his service in the army or navy of the United States, the amount of such payment is held by the Department to be a deductible expense of doing business. This ruling is applicable to guardsmen called into the army and to volunteers or conscripts who have joined the colors on either land or sea.

224.—WHEN BASED ON STOCK INTEREST.

When an amount paid as compensation to an officer or employee of a corporation is based upon the stockholding of such officer or employee, it becomes a dividend and cannot be deducted as an expense of the business. It must be treated as a dividend although paid in lieu of a salary. The United States Circuit Court of Appeals for the Second Circuit has so decided in the case of Jacobs and Davies (Inc.) vs. Anderson (228 Fed. 505.)

225.—BONUSES OR GIFTS TO EMPLOYEES.

While a gift or gratuity—when in reality it is a gift or gratuity—is not properly deductible in ascertaining the net income of a corporation, there are certain special payments in the form of bonuses, or as extra compensation, made to employees which are of such character that they constitute expenses allowable as deductions. In connection with the payment of a bonus, however, the Department insists that the special compensation be for services rendered and that the payment be in pursuance of a contract, express or implied. In a circular letter the Department has instructed Internal Revenue officers as follows:

> You are informed that in all cases where special payments, often designated as bonuses, are made to officers or employees of a corporation pursuant to a contract, express or implied, as additional compensation for services rendered, which payments, when added to the stipulated salaries, do not exceed a reasonable compensation for the services rendered, such payments may be regarded as a part of the wage or hire of the officer or employee, and, as such may allowably be deducted from gross income as a business expense.
>
> A long-time practice, regularly employed, of paying to employees certain sums in addition to the stipulated salaries, constitutes a condition, if not a contract, under which the employees may reasonably expect, for the greater or better service which they render, additional pay, and if, in fact, such payments are made as additional compensation for services actually rendered, and if such payments, when added to the stipulated salaries, do not exceed a reasonable compensation, such payments, or bonuses, may be treated as an "ordinary and necessary expense of operation," and, as such, deducted from gross income.
>
> This ruling contemplates that such payments are conditioned upon the services rendered by the employees and not upon the earnings of the corporation. If it should appear that the additional or special payments are dependent upon the earnings of the company, rather than upon the services rendered, or if such payments are made only occasionally, and then, at the option of the corporation as a sort of thank-offering because of a prosperous year, and not in pursuance of a fixed policy or practice, or any contract, express or implied, it will be held that such payments are gratuities and, as such, are not properly deductible from gross income.
>
> This ruling is not intended to authorize in any case the deduction from gross income of amounts paid to employees or others as "Christmas gifts" even though it has been the practice of the corporation to make such gifts. These are held to be voluntary contributions or donations and, as such, are not deductible.
>
> In determining whether or not the special payments above referred to are deductible, internal revenue officers will be guided by the facts as to whether or not such payments are made pursuant to a contract, express or implied, or to a fixed policy or practice, and whether or not they represent compensation for additional or more efficient service rendered, and whether or not such special payments, when added to the stipulated salary or wage, exceed a reasonable compensation.
>
> Amounts paid to an officer or employee, who is a stockholder, in excess of a reasonable compensation for his services, will be treated as in the nature of dividends, a return upon his investment, and such amounts will not be deductible.

226.—PENSIONS TO FORMER EMPLOYEES.

A pension to a former employee, or to his dependents, on account

of retirement after long service or as a result of injuries received is an allowable deduction as a business expense.

227.—DONATIONS.

A donation by a corporation will be closely scrutinized and submitted to the test as to whether there is a consideration for a benefit to the corporation. If there is no consideration, the amount given is regarded as a gratuity and, as such, cannot be deducted in a return of income. An example of a gratuity, which is not deductible, is the payment of the salary of an employee for a time after his death to his widow in recognition of his services, no service being rendered by the widow. An example of a donation, which can be deducted as a part of business expense, is a payment to a hospital upon the consideration that the employees of the corporation are to have a ward for their own use or other special care in the hospital. But, in general, the donations of a corporation are of such character as not to be deductible.

228.—FUEL, LIGHT AND POWER.

The amounts paid out by a corporation during the year for fuel, light and power are deductible operating expenses. These are to be treated the same as other items which so obviously constitute expenditure necessary in the conduct of the corporation's business.

229.—REPAIRS AND RENEWALS.

The cost of incidental repairs, which neither add to the value of the property repaired nor prolong its life to any extent, may be deducted as an expense of operation. Such repairs must not be so extensive as to constitute an addition or betterment; they must not go beyond the point of keeping the property in an operating condition.

An example of the precise and discriminating application of the limitation upon the cost of repairs as an allowable deduction for expense is to be found in the case of Grand Rapids & Indiana Railway Company v. Doyle, Collector, decided in the United States District Court for the Western District of Michigan, Southern Division. The court drew the distinction between cost of repairs and cost of betterments by holding that where old rails are replaced with new and heavier rails, wooden bridges and culverts with concrete and steel bridges and culverts, the rule is that the cost of renewals with like kind and quality is allowable, but the excess cost is not allowable as a deduction.

In considering the allowance for repairs the taxpayer should also

give close attention to the allowance for depreciation, for the law contemplates a deduction on account of the exhaustion, wear and tear, of property from its use or employment in business, in addition to the expenditure necessary to keep the property in an operating condition. [See instructions regarding "Depreciation."]

230.—EXPENSES OF ENTERTAINMENT.

Money advanced to salesmen for entertainment when the spending of it is a part of the selling expense of the corporation's product can be deducted by the corporation as a business expense.

231.—BUILDINGS ON LEASED GROUND.

When a building is erected on leased ground under an agreement that it is to be left on the ground at the expiration of the lease, the cost is held to be a proper deduction as a rental charge. This cost should be prorated over the number of years constituting the term of the lease and the prorata belonging to one year treated as a business expense in the corporation's return for each year thereafter until the expiration of the lease.

232.—IMPROVEMENTS ON LEASED PROPERTY.

And the same rule applies to expenditures for repairs or improvements on leased premises if the tenant occupies the premises under a lease contract which requires that such repairs and improvements be made at the expense of the tenant and revert to the owner of the fee at the expiration of the lease. The cost can be deducted by the tenant as a part of the general expense of doing business. In case of an expenditure for an improvement of somewhat permanent character, the cost of the improvement should be prorated over the term of the lease.

233.—POLITICAL AND LOBBYING EXPENSES.

Contributions to political campaigns and expenditures in lobbying cannot be deducted in a corporation's return of income. While such expenditures may be regarded as a very considerable item of expense, the Treasury Department holds that they are not the "ordinary and necessary expenses" authorized as deductions by the law.

234.—EXPENSE ACCOUNTS PAYABLE.

Accounts payable, when they represent the ordinary and necessary business expenses allowed by the law as deductions, may be deducted from gross income of the year in which the expenses are incurred, provided the accounts have been so entered upon the books of

the corporation as to constitute a liability against the assets of the corporation and as not to be included in the deductions for the year in which actually paid in cash. This privilege is even extended the corporation which does not avail itself of the general right given by the law to make return according to its own method of accounting, subject to approval by the Treasury Department, provided it prefer its own method to a strict basis of actual receipts and disbursements.

235.—INTEREST AS EXPENSE RATHER THAN INTEREST DEDUCTION.

Interest paid by a corporation on indebtedness which is wholly secured by property collateral the subject of sale or hypothecation in the ordinary business of the corporation, as a dealer only in the property constituting such collateral must be deducted as a business expense. It is not to be included in the general deduction on account of interest paid. There is reason for this. Subject only to the limitation that the amount of the indebtedness on which such interest paid is allowable as a deduction shall not exceed the actual value of the property collateral, the entire amount of interest paid during the year on indebtedness thus secured can be deducted. On the other hand there is a strict limitation upon the separate deduction for interest. (For further explanation see treatment of deductions for interest.)

236.—EXPENSES IN CONTRACTING BUSINESS.

If a corporation is engaged in the contracting business and makes its return of income upon the basis of completed jobs, it must confine its deductions for operating expense to expenditures made on account of such completed contracts.

237.—INCOME FROM PUBLIC UTILITY DUE STATE, CITY, ETC.

If a public utility has been constructed and is operated under a contract with a State or Municipality providing that a portion of the net earnings shall be paid to the State or Municipality, the amount so paid is regarded as a business expense to the corporation (or individual) operating the public utility and, as such, may be deducted in a return of income.

238.—MISCELLANEOUS EXPENSES.

There are many other items of expense properly to be considered in ascertaining the net income of a corporation subject to tax. All of them cannot be named here. But the language of the law is comprehensive. "All the ordinary and necessary expenses paid within the

year in the maintenance and operation of its business and properties," it reads; and the Treasury Department has interpreted the provision of the statute to mean that "expenses of operation and maintenance shall include all expenditures for material, labor, fuel and other items entering into the cost of the goods sold or inventoried at the end of the year, and all other expenses incurred in the operation of the business except such as are required by the Act to be segregated in the return." (Referring to interest, taxes, losses, depreciation and depletion.)

B.—LOSSES

239.—MUST BE ABSOLUTE AND COMPLETE.

The deduction allowed for losses must be considered separately from that allowed for depreciation of physical property due to wear and tear, or that allowed for depletion of natural deposits in the earth. Under the item of **"Losses"** deduction can be claimed only for such a loss as has been actually sustained during the year, without compensation in the form of insurance or otherwise. The loss must also have been charged off on the books during the year. In every sense it must be complete and absolute, without apparent possibility of recovery. Unless the loss can meet this severe test it will not be allowed, for of all the items of deduction in a return of income that which receives the most critical scrutiny is the item of losses. Hence, the corporation must have data to support its claims on account of losses. It will only waste time and effort by writing estimated losses into the return it is required to file with the Government.

240.—LOSS FROM SALE OF PROPERTY.

A loss from the sale or other disposition of property, real or personal, is ascertained precisely as explained with reference to determination of gain in a similar transaction. In the case of property acquired prior to March 1, 1913, the loss is the difference between the fair market price or value of the property as of that date and the selling price, where the selling price is less than the market price or value as of March 1, 1913. In the case of property acquired on or after March 1, 1913, the loss is the difference between selling price and cost, where the selling price is less than the cost.

This provision of the law can be applied to transactions in stocks and bonds as well as to dealings in real estate.

Items of Cost.

With respect to property acquired on or after March 1, 1913, (in which case **cost** is the basis for calculating gain or loss) certain items

in addition to purchase price may be considered in ascertaining cost. To the purchase price may be added expense incident to purchase, the cost of improvements, special assessments paid for local benefits and, in certain cases, the carrying charges against the property. With reference to the inclusion of carrying charges, the Department holds that, where they exceed income from the property, the amount of the excess can be considered in ascertaining cost of the property. This ruling does not mean that carrying charges, if they consist of such expenditures as constitute allowable deductions from gross income, are to be added to the cost of the property, if there is a gross income from which they can be deducted; but it does mean that in the case of a corporation which has not yet progressed to the point of having any income of consequence from its corporate operations, the excess of the carrying charges over the incidental income received may be made a part of the cost of the property.

241.—BAD DEBTS.

Any amount represented by a bad debt, charged off the corporation's books during the year, can be deducted. It is essential, however, that the amount have been charged off. If subsequently the amount is recovered it must be accounted for as income for the year in which recovered.

Under this heading would be proper as a deduction any amount lost on account of a sale of real estate in the case of a sale with the consideration represented in whole or in part by deferred payments covered by notes and a mortgage.

Also under this heading should be deducted loss sustained on account of the insolvency of a corporation with an outstanding bond issue. The bonds are a debt of the corporation which has issued them and the bondholder is the creditor. If insolvency of the corporation has made the bonds worthless, the holder of them is entitled to deduct the amount of loss as a bad debt.

242.—LOSSES FROM CASUALTY.

Losses from casualty, such as fire, storm, shipwreck or theft, are deductible by a corporation, if not compensated for by insurance or otherwise. If the amount of loss sustained by casualty can be shown to be in excess of the amount of insurance, the amount of such excess is deductible.

243.—COST, SALVAGE, PREVIOUS DEPRECIATION.

Cost value and salvage value must be considered in determining

the amount of loss with respect to any property. Also a factor in such computation is the amount which has at any time been deducted from gross income for depreciation of the property in question and which has not been expended in making good the depreciation.

244.—REMOVAL OF BUILDINGS.

If a building is voluntarily removed to make room for a new building there is no loss sustained which is deductible as a loss, according to the ruling of the Department. Such loss is either a proper charge to the cost of the new building or is presumed to have been taken care of in previous deductions for depreciation. So much of such loss as has not been covered by depreciation charges should be added to and made a part of the cost of the new building, for the purposes of the income tax law. In any case it does not enter into the computation of net income for the year in which the old building is removed.

245.—SELLING BONDS AT DISCOUNT.

Where a corporation issues bonds, redeemable at par, and disposes of such bonds at a price less than par, there is plainly a proper charge to be made against the gross income of the corporation. The difference between sale price and par is a loss. Both the Treasury Department and the courts, have held, however, that the amount of this loss must be prorated by the corporation over the life of the bonds, the proportion of the amount of the discount belonging to one year to be charged against gross income for each year.

For example: A twenty-year bond for $100, redeemable at par, would, if disposed of at $80, mean a loss of $20, to be prorated over the twenty years constituting the life of the bond. On account of such bond the corporation would be entitled to claim a deduction for loss to the amount of one dollar in its return for each year during the life of the bond.

A corporation is not allowed to charge the entire amount of a discount in the sale of its bonds against gross income for the year in which the bonds are disposed of. In the case of the Baldwin Locomotive Works vs. McCoach, Collector [221 Fed. 59], the United States Circuit Court of Appeals for the Third Circuit held to the effect that, while the amount of the discount in such a case is properly chargeable against gross income, **it will not be paid until the maturity of the bonds and therefore should be prorated over the life of the bonds.**

However, with respect to this question of bond discount, it is well to note that in a case where a corporation disposed of its bonds at a

discount prior to the year 1909 and at the time charged the entire amount of the discount against income for the year in which the bonds were sold, such corporation cannot, in a return for any subsequent year, claim any part of the amount of the discount as a loss. Reference is made to the year 1909 because the Corporation Excise Tax (forerunner of the Corporation Income Tax) became effective January 1, 1909.

246.—RETIRING BONDS ABOVE PAR.

By official letter the Treasury Department has given a clear and concise ruling with respect to the situation created when a corporation is required, under the terms of its indenture securing a bond issue, to purchase and retire annually a certain number of its bonds, and when the corporation must pay more than par for the bonds it is required to retire. In such circumstances, a loss is generally sustained. As to the treatment of such a loss the Treasury Department has ruled as follows:

> If the bonds were issued at par, then the corporation may deduct the difference between par and the price at which purchased for retirement.
>
> If the bonds were issued at a premium and such premium accounted for as income for the year in which issued, then the difference between par and the purchase price may be deducted as a loss; but, if the premium at which the bonds were issued had not been carried into income account, then the loss to be claimed should be the difference between the price at which the bonds were issued and the purchase price.
>
> In the event that the bonds were issued at a discount and the discount was charged against the earnings of the year in which issued, the difference between par and the purchase price may be deducted as a loss; but if the discount on the bonds was prorated over the life of the bonds and the annual proportion charged against the yearly income, the amount to be charged off as a loss for the year in which the bonds are purchased for retirement should be the difference between the price at which the bonds were issued and the purchase price minus an allowance for the sums that had been charged off annually on account of the prorated discount on such bonds.

247.—INFORMATION MUST BE EXACT.

There can be no guesswork or approximation in connection with a claim for deduction on account of loss. In the form of return, provided by the Government, will be found specific questions, which must be answered. Not only must the kind of asset involved in the loss be stated, but also how and when the loss was ascertained to be such, with full data relative to cost, or fair market price or value as of March 1, 1913, as the case may be. If fair market price or value as of March 1, 1913, is the basis of determining loss, the method of ascertaining such fair market price or value must also be explained.

C.—DEPRECIATION

The subject of depreciation of physical property, and the charge that may be made against gross income on this account, is one that concerns both the corporation and the individual. It has given rise to many vexing problems, to many differences of opinion; and, no doubt, always will. However, the basic requirements of the law, as interpreted by the Treasury Department, can be laid down and the taxpayer, corporation or individual, should adhere to them with all possible fidelity. This advice is given because deductions from gross income on this account are looked into very carefully by the Government.

It has been thought best to explain the subject in a separate chapter; hence the taxpayer is referred to the special chapter on **"Depreciation of Physical Property."**

D.—DEPLETION

As in the case of deduction for depreciation, so with respect to deduction for depletion, it has been thought best to cover the subject in a special chapter under the heading, **"Depletion of Natural Deposits."**

It is a difficult problem to solve in most cases—this determination of the fair annual allowance for exhaustion of deposits hidden away in the earth. Ever since the Corporation Excise Tax law of August 5, 1909, became effective controversy between the Government and taxpayers on the subject has been acute, and, no doubt, will be continued. However, the requirements of the Government can be set forth and taxpayers will do well to follow them even though they may think that the Treasury Department is as far from an equitable solution of the problem as it was in the first place. Hence, the taxpayer is referred to the special chapter as above indicated.

E.—DEDUCTION OF INTEREST

The deduction for interest is one governed by a specific and arbitrary limitation imposed by law and by several provisional clauses to which the closest attention should be given. A number of decisions have been made and interpretations issued by the Treasury Department. However, before going into their meaning, it has been thought best to quote here the provision of the law allowing deduction for interest. The language of the statute (to be found in the "Third" paragraph of subdivision (a) of Section 12) follows, with special division of the subject into "Parts" for the sake of convenience and explanation:

PART 1.

The amount of interest paid within the year on its indebtedness

(except on indebtedness incurred for the purchase of obligations or securities the interest upon which is exempt from taxation as income under this title) to an amount of such indebtedness not in excess of the sum of
(a) the entire amount of the paid-up capital stock outstanding at the close of the year, or, if no capital stock, the entire amount of capital employed in the business at the close of the year, **and**
(b) one-half of its interest-bearing indebtedness then outstanding:

PART 2.

Provided, That for the purpose of this title preferred capital stock shall not be considered interest-bearing indebtedness, and interest or dividends paid upon this stock shall not be deductible from gross income:

PART 3.

Provided further, That in cases wherein shares of capital stock are issued without par or nominal value, the amount of paid-up capital stock, within the meaning of this section, as represented by such shares, will be the amount of cash, or its equivalent, paid or transferred to the corporation as a consideration for such shares:

PART 4.

Provided further, That in the case of indebtedness wholly secured by property collateral, tangible or intangible, the subject of sale or hypothecation in the ordinary business of such corporation, joint-stock company or association as a dealer only in the property constituting such collateral, or in loaning the funds thereby procured, the **total interest paid** by such corporation, company, or association within the year on any such indebtedness **may be deducted as a part of its expenses of doing business,** but interest on such indebtedness shall only be deductible on an amount of such indebtedness not in excess of the actual value of such property collateral:

PART 5.

Provided further, That in the case of bonds or other indebtedness, which have been issued with a guaranty that the interest payable thereon shall be free from taxation, no deduction for the tax herein imposed, or any other tax paid pursuant to such guaranty, shall be allowed:

PART 6.

And in the case of a bank, banking association, loan or trust company, interest paid within the year on deposits or on moneys received for investment and secured by interest-bearing certificates of indebtedness issued by such bank, banking association, loan or trust company shall be deducted.

248.—ON LOAN TO BUY TAX-FREE BONDS.

First consider the exception with respect to interest paid on indebtedness incurred for the purchase of bonds the interest on which is not subject to tax. **(Part 1 above).** This was written into the law by an amendment carried by the War Revenue Act of October 3, 1917, and refers to indebtedness incurred to purchase United States, State,

Municipal, School, and similar bonds—the securities specially favored by the law and more fully described elsewhere under appropriate headings in this book. It has no reference to the so-called "tax-free" bonds issued by corporations.

An example: A corporation borrows $100,000 and invests the amount in school district bonds. **It cannot deduct the interest paid on the indebtedness of $100,000.** Suppose it has borrowed the money at 6 per cent and has bought school bonds paying 6 per cent interest. It would not have to include in its statement of income the $6,000 in interest earned by the school bonds but, if it were allowed to deduct the $6,000 in interest paid on the loan of $100,000, such deduction would be a charge against income from sources other than the school bonds and the amount of tax liability on income from those other sources would be accordingly decreased.

The purpose of the law is plain. Where it is allowable to deduct interest paid on such a loan, transactions of this kind might be carried to almost any extent to evade taxation.

249.—INTEREST MUST HAVE BEEN PAID.

Interest to be deductible not only must have been computed according to law, but must also have been actually paid within the year for which the return is made.

250.—BASIS OF COMPUTATION.

The statute places a specific limitation **(Part 1, above)** upon the amount of indebtedness on which deductible interest can be computed —that is, interest other than such interest as is described in **Parts 4 and 6, above.**

This limitation is ascertained by adding to the amount of the paid-up capital stock outstanding at the close of the year one-half of the interest-bearing indebtedness, also then outstanding. Such is the maximum principal on which deductible interest can be computed. In the case of a corporation with a paid-up capital stock of $100,000, a bond issue of $250,000 and no other indebtedness outstanding at the close of the year, the maximum principal would be the sum of $100,000 and $125,000 (½ of $250,000) or $225,000. Thus, in such circumstances (and this is often the case) the corporation could not deduct the entire amount of interest paid on its bonds, but would be limited to interest paid on them only to the amount of $225,000 of the par value of the bonds.

251.—PAID-UP CAPITAL STOCK.

By **"Paid-up Capital Stock"** is meant the par value of the stock issued and outstanding at the close of the year, without consideration of any surplus the corporation may have. However, when the stock has been sold according to an installment plan and has not been entirely paid for, **the amount actually paid on it** represents "paid-up capital stock," holds, the Department. But if payment in any form (by cash, promissory notes or by other assets) has been made **in full,** then the par value of the stock issued and outstanding at the close of the year is to be taken into the computation.

252.—IF STOCK HAS NO PAR VALUE.

When a corporation issues stock without giving to each share a par or nominal value **(Part 3, above),** the law provides that the amount to be taken into the computation with respect to deductible interest is the **amount paid to the corporation for its stock,** and, as hereinbefore noted, payment may be in cash or the equivalent of cash in the form of notes or other assets. [See fourth paragraph farther on headed **"Common Stock As a Bonus, Etc."**]

253.—IF NO CAPITAL STOCK.

If no capital stock has been issued **(Part 1, above)** it is provided that the **entire amount of capital employed in the business** at the close of the year shall be considered the same as "paid-up capital stock."

254.—OUTSTANDING AT CLOSE OF YEAR.

The law is again specific **(Part 1, above)** in fixing a maximum of principal according to both paid-up capital stock and interest-bearing indebtedness **outstanding at the close of the year,**—that is, at the close of the year for which the corporation makes its return and which may be either the calendar year or the corporation's own fiscal year.

Suppose a corporation with an outstanding paid-up capital stock of $100,000 (par value) has carried an indebtedness of $250,000 for the greater part of the year but on the first day of October was able to and did pay this indebtedness in full, so that on the last day of December it did not have any indebtedness outstanding. During the year it paid interest on its indebtedness. How would its deduction for interest be computed? The Treasury Department answers in Treasury Decision 1960 as follows:

If no indebtedness is outstanding at the close of the year, the maximum deduction allowable on account of interest paid, will be the amount of interest actually accrued and paid on an amount of indebted-

ness not exceeding at any time within the year, the entire paid-up capital stock outstanding at the close of the taxable year [in this case the last day of December,] that is, in such case, the paid-up capital stock outstanding at the close of the year measures the highest amount of indebtedness upon which deductible interest can be computed.

In the example given, according to the Department's interpretation of the law, the maximum principal on which deductible interest could be computed would be $100,000.

Were the example changed to provide merely for a reduction of the indebtedness of $250,000 late in the year, leaving $150,000 of it outstanding at the close of the year, the maximum principal would be $100,000 plus $75,000 (½ of $150,000) or $175,000.

255.—DIFFERENT RATES OF INTEREST.

Bearing upon this question attention is directed to one of the few rulings issued on January 5, 1914, in Regulations No. 33 and still in effect. It follows:

Interest on bonded or other indebtedness **bearing different rates of interest** may be deducted from gross income during the year, provided the aggregate amount of such indebtedness on which the interest is paid does not exceed the limit prescribed by law, and in case the indebtedness is, in excess of the amount on which interest may be legally deducted, **the indebtedness bearing the highest rate may be first considered** in computing the interest deduction and the balance, if any, will be computed upon the indebtedness **bearing the next lower rate** actually paid, and so on until interest on the maximum principal allowed has been computed.

256.—COMMON STOCK AS BONUS, ETC.

As special problems have arisen they have necessitated amplification of the Department's interpretation of the law. Particularly has this been true with respect to issues of stock without par value and issues of common stock as a bonus in connection with preferred stock. In an official letter the Department has stated its understanding of the requirements of the law as follows:

"Paid-up capital stock," is held to mean that amount of capital paid in and for which certificates or shares are issued. For the purpose of the act, it is not essential that the shares, when issued, shall have set out therein a nominal or par value. Hence, for the purpose of the act, it is held that shares of stock issued, whether with or without a par or nominal value, are "paid-up capital stock" within the meaning of the law; and the amount of "paid-up capital stock" to be set forth in the return, as one of the determining elements in computing the amount of interest which may be allowably deducted, is the amount of capital (cash or its equivalent) actually received by the corporation and for which shares are issued.

In the case of shares of stock issued with a par value fully paid up and non-assessable, the par value of all such shares so issued is the paid-up capital stock of the corporation.

In the case of shares of stock issued without par value, the amount of capital actually received and for which such shares are issued is the paid-up capital stock.

As in the case of capital stock issued with par value, so in the case of stock issued without par value, the amount of the "paid-up capital stock," for the purposes of this act, cannot be increased except as new capital is paid in and for which additional shares are issued.

In cases wherein shares of stock are issued without par value, such stock is obviously common stock. If it should occur that such shares are issued in addition to or as a bonus in connection with shares of preferred stock, which latter must necessarily have a par or nominal value, and the entire capital paid in is represented by the par value of the preferred stock, then and in that case the "paid-up capital stock," for all the purposes of the income tax law, will be the par value of the preferred stock.

If both common and preferred stock are issued for a cash or other equivalent consideration, the "paid-up capital stock," within the meaning of the law, will be the par value (if fully paid in) of the preferred stock plus the amount actually paid in on the shares issued without par or nominal value.

It is therefore held that a corporation whose shares of stock are issued without par value has a "paid-up capital stock" within the meaning of the law, equal to the amount paid in for such stock, and it will be authorized to compute its interest deduction in accordance with the rule set out in the law for corporations having a paid-up capital stock the paid-up capital stock in such cases being the actual paid-in capital for which shares are issued.

257.—INTEREST ON PREFERRED STOCK.

With respect to the interest, so-called, or dividends, paid on preferred capital stock **(Part 2, above)** issued by a corporation, the law provides there shall be no deduction.

258.—INTEREST ON INDEBTEDNESS SECURED BY COLLATERAL WHICH IS SUBJECT OF SALE IN CORPORATION'S BUSINESS.

Referring to **Part 4** of the quotation from the Income Tax law in regard to deductions of interest, a corporation should give the closest attention to the very important exception with respect to interest paid on **indebtedness wholly secured by property collateral, tangible or intangible, which property is the subject of sale or hypothecation in the ordinary business of the corporation as a dealer only in the property constituting the collateral, or in loaning the funds procured.**

The importance of this exception is due to the provision that interest paid on such indebtedness is deductible **as one of the expenses of doing business and is not to be considered as a part of the general deduction for interest,** limited as hereinbefore explained.

Moreover, the amount of any indebtedness secured by such collateral is not to be included in the statement of interest-bearing indebtedness outstanding at the close of the year for the purpose of ascertaining the maximum principal on which the general interest deduction can be computed.

Indebtedness secured by such collateral stands by itself, and **the entire amount of interest paid on it is deductible as an expense of doing business,** subject only to the statute's limitation that "interest on such indebtedness shall only be deductible on an amount of such indebtedness not in excess of the actual value of such property collateral."

In other words, the amount of interest paid on such indebtedness does not go into a return of income as a part of the general deduction for interest, but does go in as one of the items of **general expenses,** along with such other items as expenditures for labor, fuel, power, rent, repairs and the like.

259.—WHAT COLLATERAL IS MEANT?

Naturally, the first question that occurs to the taxpayer is: "What collateral is meant to be included and what character of loan comes within the indebtedness referred to and favored by the statute?"

The Department has gone to some pains to explain the law and to emphasize its insistence upon a very close adherence to the exact language of the Act.

"Collateral," as used in this connection, the Department holds, comprehends any form of property bound for the payment of an obligation.

The basic requirement is that the property shall be the **subject of sale or hypothecation in the ordinary business of the corporation as a dealer only in the property constituting the collateral, or in loaning the funds procured.**

A corporation engaged exclusively in buying, selling and dealing in the particular kind of property which is pledged for the obligation is entitled to deduction of the amount of interest paid as **an expense of doing business.**

In the case of a corporation engaged exclusively in dealing in real estate, the collateral, referred to in the law, would be the real estate which it might mortgage to protect indebtedness. However, in this connection, attention is called to a limitation imposed by the Department in Treasury Decision 2137, which reads as follows:

> Real estate to constitute collateral within the meaning of this clause of the law must be such real estate as is in fact the subject of sale in the ordinary business of the corporation. If the corporation whose ordinary business is the purchase and sale of real estate has an office building under mortgage, which office building is not subject to sale in the ordinary business of the corporation, the interest paid on such mortgage will not be deductible [as an expense of doing business.]

And again in Treasury Decision 1993 the Department has held that the law

> does not authorize the deduction as "an expense of doing business" of any interest paid on indebtedness secured by property, real or personal, which is not the "subject of sale in the ordinary business of the corporation," but **which is held by it for the purpose of, or as an instrument in carrying on, its ordinary business**—such as the rights of way and other property of public utility companies, permanent office buildings and property of like character held or occupied for their own particular use or purpose in the furtherance of the objects of the corporation, but which property is not the subject of sale in the ordinary business, and which is simply occupied or used as an instrument or means of or essential to carrying on of the ordinary business for the transaction of which they are organized. **The fact that such property may be subject to sale under extraordinary or peculiar conditions does not qualify but rather disqualifies, it as "collateral" such as is contemplated by the provision of the act cited.**

The meaning of the law must be apparent. Each corporation will have to work the matter out for itself, but in doing so will be required to furnish data in a supplementary statement made a part of its return of income. The character of the property collateral and the relation of the property to the ordinary business of the corporation are the controlling considerations.

260.—TAX-FREE COVENANT IN BONDS.

With reference to the issuance of bonds **(Part 5, above)** by corporations with a guaranty that the interest paid on them shall be free from taxation, the position of the Government is really that of an outside party. The stipulation in the bonds is a contract wholly between the corporation and the bondholder, insists the Treasury Department. The interest paid is subject to tax in the hands of the bondholder the same as any other interest, and the amount of it enters into determination of the bondholder's liability. In the case of bonds of this character, when no ownership certificate claiming exemption is filed by the bondholder, the corporation withholds the normal tax and reports and pays such withholding to the Collector as tax withheld on payments of interest to the holders of its bonds. The bondholders then account for the amount of interest as income which has been taxed at the source. In no circumstances is the tax on such interest allowable as a deduction in arriving at the amount of tax due on the income of the corporation.

261.—INTEREST PAID BY BANKS.

The interest paid by a bank **(Part 6, above)** on deposits or on money received by it for investment and secured by interest-bearing certificates of indebtedness issued by the bank is deductible in full without reference to the limitation with respect to amount of capital

and interest-bearing indebtedness outstanding at the close of the year. In the form on which a corporation is required to file return will be found a special line for the deduction of this item. In other words, a banking corporation should state the item separately and not add it either to the general interest deduction or to the expense of doing business.

F.—DEDUCTION OF TAXES

In the first place, a tax, to be deductible in a corporation's return must have been actually paid during the year for which the return is made. A reserve for taxes is not allowable as a deduction. The language of the law, "taxes paid," can have only one interpretation.

Exceptions in Law.

The law mentions three exceptions:

(a) Federal Income Tax.

(b) Federal Excess Profits Tax.

(c) Taxes assessed against local benefits.

Denial of the right to deduct the amounts paid the Government as Income and Excess Profits taxes was written into the law by amendments carried by the War Revenue Act of October 3, 1917. Prior to such amendment the Federal Income tax could be included in the deduction for taxes; but not now. However, this exclusion of the Federal Income tax from the deduction does not apply to the income tax imposed by any State. It is limited to the Federal tax.

The Federal excess profits tax is not allowable as a deduction for taxes and in the determination of net income, as "net income" is defined in Paragraph 1 of Chapter II. The law provides, however, that in assessing income tax the amount of net income, ascertained without allowancce of any excess profits tax paid as a deduction, is to be credited with the amount of excess profits tax assessed for the same tax year.

A tax assessed against a local benefit has been hereinbefore explained. See paragraph, **"Taxes Against Local Benefits,"** in instructions to individuals relative to the deductions allowed them.

Exceptions by Regulation.

But the Department has held that certain other taxes paid by corporations are not deductible.

The State Inheritance Tax is not deductible, because it is chargeable to the corpus of the estate. It is not, therefore, to be deducted

either in the return of income of the executor of the estate or in the return of income of the beneficiaries.

Taxes paid by a banking corporation for its shareholders upon its capital stock are not deductible. This tax cannot be deducted by the bank but can be deducted by the shareholders. This exclusion does not, however, extend to an excise or franchise tax imposed upon the banking corporation itself and required to be paid to the State as a condition of doing business.

No tax paid by a corporation pursuant to a covenant in its bonds guaranteeing that the interest on such bonds shall be free from taxation can be deducted. The Government, as hereinbefore explained, regards such a covenant only as an agreement between the corporation and its bondholder, and tax liability with respect to the interest as income remains the liability of the recipient of the interest, the bondholder, notwithstanding the guaranty in the bond.

With the exceptions noted, taxes are deductible in the corporation's return for the full amount paid during the year—not for the full amount assessed, but for the full amount actually paid.

262.—PECULIAR INSURANCE DEDUCTIONS.

The law takes cognizance of items of deduction peculiar to the insurance business and makes allowance for them. With respect to these special deductions it provides

> **for an allowance, in the case of insurance companies, of the net addition, if any, required by law to be made within the year for which the return is made to reserve funds and the sums other than dividends paid within the year on policy and annuity contracts.**

There are, however, several distinct provisos with reference to the income of various kinds of insurance companies. They are as follows:

> (a) **Mutual fire, mutual employers' liability, mutual workmen's compensation and mutual casualty** insurance companies, which require their members to make premium deposits to provide for losses and expenses, should not include in a return of income any portion of the premium deposits returned to their policyholders, but must return for taxation all income received by them from all other sources plus such portions of the premium deposits as are retained by the companies for any purpose other than the payment of losses and expenses and re-insurance reserves.

(b) **Mutual marine** insurance companies must make their statement of gross income in a return of income include gross premiums collected and received less amounts paid for reinsurance. Against this gross they are allowed as deductions any amounts repaid to policyholders on account of premiums previously paid by such policyholders and any interest paid upon such amounts (paid to policyholders) between ascertainment and payment.

(c) **Life insurance** companies should not include in a return for any year "such portion of any actual premium received from any individual policyholder as shall have been paid back or credited to such individual policyholder, or treated as an abatement of premium of such individual policyholder, within the year."

Insurance Reserves.

Referring to the special deductions provided for, the Treasury Department has held that the reserve fund of an insurance company to be considered in ascertaining the **"net addition to reserve funds,"** deductible under the law, shall include only the reinsurance reserve and the reserve for supplementary contracts required by law in the case of life insurance companies, the unearned premium reserves required by law in the case of fire, marine, accident, liability, and other insurance companies, and such other reserves as are specifically required by the laws of the State in which the insurance company is engaged in business. There must not be included the reserve on any policy the premiums on which have not been accounted for in gross income. By **"Net Addition"** is meant the excess of the reserve at the end of the year over that at the beginning of the year. In the case of assessment insurance companies, any amount actually deposited with a State officer in compliance with law, as an addition to a reserve or guaranty fund, is allowable in the computation of the deductible "net addition."

Payments on Policies.

In the return form heretofore used special place was provided for the deduction of payments on policies (distinct from all other deductions). Thus deduction is allowed, according to Departmental ruling, for all death, disability, or other policy claims, including fire, accident, and liability losses, matured endowments, annuities, payments on installment policies, surrender values, and all claims actually paid under the terms of policy contracts. If salvage is deducted in ascertaining

the net amount paid for losses, it is not required to be included in gross income. But the losses, to be deductible. must have been actually paid. Reserves covering liabilities for losses, incurred but not paid, cannot be deducted.

263.—DEDUCTIONS OF FOREIGN CORPORATION.

A foreign corporation is entitled to deduct from its gross income received from all sources within the United States during the year for which the return is made all the items of deduction allowed corporations in general, except that such deductions must be limited to expenditures or charges incurred in connection with its interests in the United States—in other words, must be immediately related to its receipt of income from sources within the United States. A foreign corporation cannot charge against gross income from sources within the United States any item of expenditure having to do with its business or its investments without the United States.

Operating expenses, losses, depreciation and depletion allowances are deductible, provided they relate to the business and property of the foreign corporation within the United States.

All the deductions peculiar to corporations engaged in the insurance business are allowable to foreign corporations with respect to insurance business conducted by them in the United States.

Interest is deductible by a foreign corporation according to a method specifically provided in the law, as follows:

> The amount of interest paid within the year on its indebtedness (except on indebtedness incurred for the purchase of obligations or securities the interest upon which is exempt from taxation under this title) to an amount of such indebtedness not in excess of the proportion of the sum of (a) the entire amount of the paid-up capital stock outstanding at the close of the year, or if no capital stock, the entire amount of the capital employed in the business at the close of the year, and (b) one-half of its interest-bearing indebtedness then outstanding, which the gross amount of its income for the year from business transacted and capital invested within the United States bears to the gross amount of its income derived from all sources within and without the United States.

To apply the above prescribed method a foreign corporation should add to the amount of its paid-up capital stock, or if no capital stock, then the amount of capital employed in its business, one-half of its interest-bearing indebtedness, both capital stock and indebtedness outstanding at the close of the year. If its gross income from the United States is one-third of its entire gross income, then one-third of the above sum obtained by adding to paid-up capital stock one-half of interest-bearing indebtedness, is the maximum principal upon which deductible interest may be computed.

In the case of a bank, interest paid within the year on **deposits by or on money received for investment from either citizens or residents of the United States** is deductible in full, as in the case of a domestic banking corporation, and separately from the general deduction for interest as limited by paid-up capital stock and interest-bearing indebtedness.

With respect to taxes a foreign corporation is limited in its deduction to taxes **paid within the United States.** It is not allowed deduction for a tax imposed by a foreign country, as is a domestic corporation. The reason for this is obvious. A domestic corporation must account for income from all sources, a foreign corporation only for income from sources within the United States.

CHAPTER XVII

THE INCOME TAX

DEPRECIATION OF PHYSICAL PROPERTY.

264.—DEPRECIATION DEFINED.

The income tax law allows a deduction from gross income on account of the depreciation of physical property due to exhaustion, wear and tear in the use of the property in the business or businesses of the taxpayer. It also allows a deduction on account of obsolescence, which will be explained hereinafter.

The deduction for depreciation, made and claimed in a return of annual net income, is supposed to be the amount of the loss, incurred during the year for which the return is made, in the value of the property—**a loss which has not been made good by expenditures for ordinary repairs and maintenance during the year**—a loss representing an appreciable deterioration in value as a business property, even though such property may have been repaired from time to time to keep it in operation.

265.—BASIS OF DEPRECIATION.

Manifestly a deduction on account of depreciation is an estimate, but if instructions are followed this estimate may be made very nearly accurate. The claim for allowance should be based upon the assumed life of the property, its cost and the use to which it is put. First must be considered the cost, as it is this cost which the law contemplates shall be covered eventually by the aggregate of annual allowances; then, should be ascertained the probable number of years constituting the life of the property, for it is over such a period that the loss due to depreciation is sustained. In other words, the cost of the property, for the purpose of arriving at a proper deduction for depreciation, should be ratably spread over its life.

That the position of the Treasury Department may be set forth clearly with respect to this allowance, the ruling made in an official letter of the Department is quoted. Such ruling is as follows:

> The amount of the allowable depreciation deduction should be credited to a depreciation reserve account, against which account will be charged the cost of renewing or replacing the property with respect to which the depreciation is claimed.
>
> **It is not contemplated that such ordinary incidental repairs as keep the property in an operating condition shall be charged to this depreciation reserve but such cost may be charged to the expense of operation and maintenance.** In other words, the depreciation deduction is intended to provide a fund out of which the loss due to depreciation occasioned by use, wear and tear, may be made good.
>
> This office recognizes the fact that a building or a piece of machinery or other equipment, **as a whole,** may deteriorate in value and usefulness by reason of wear and tear, regardless of the fact that certain minor component parts may be renewed, restored or replaced. The depreciation deduction authorized by the law therefore contemplates the creation of a fund that will renew, restore or replace **the original property** when it has become worn out or exhausted, **regardless of the renewal and restoration of parts that may have been made in the meantime.**
>
> Hence it is held that in addition to the depreciation deduction intended to cover the cost of the property as a whole, the expense of incidental repairs which do not add to the value of the property but merely keep it in an operating condition, may be allowably deducted from gross income as an expense of operation and maintenance.
>
> It is barely possible in some instances that worn-out parts of a machine or similar equipment may be renewed one after another until the original machine or equipment is swallowed up in the renewed parts and the machine or equipment is then in as good operating condition as it originally was. In this case, if the cost of renewal parts is charged to operating expense, no deduction on account of depreciation should be claimed or allowed as to such machine or equipment.
>
> This would appear to be true in the case of pipe lines, worn-out pipe covering and similar articles of equipment. By replacing one joint of pipe after another, all may be replaced, and if the expense is deducted as an operating expense, any depreciation fund that may have been reserved for the purpose of restoring the pipe line as a whole will remain unused.
>
> So that in cases of this kind, if a depreciation reserve is set up to cover property that may be renewed or restored part by part, until the whole is renewed, the cost of the renewed parts should be charged to the depreciation reserve fund and will not be considered incidental expenses within the meaning of the regulations.
>
> **"Incidental repairs" refers only to those repairs which are, as the term signifies, only incidental to the operation of the property and which will not, if continued as the component parts wear out and are restored, make permanent the property.**
>
> Hence the depreciation deduction allowable with respect to any property, is such an amount as, in the aggregate, when the property as a whole is worn out, will replace it or return to the corporation (or individual) the capital invested in it. That is to say, the depreciation deduction allowable under the law and the regulations, should be only such an amount as will take care of loss due to the general wear and tear, and which is to no extent compensated by expenditures made for repairs.
>
> It is the opinion of this office that expenditures for replacing worn-out parts such as gears, bolts, nuts, valves, etc., so long as such replacements are not pursued to the extent and for the purpose of finally restoring the machinery or equipment as a whole, constitute incidental

> **repairs, and expenditures of this character are deductible from gross income as an operating expense, the depreciation deduction with respect to the property so repaired being reserved to replace the machinery, equipment or building when, as an entirety, it is worn out or is worthless for the purpose for which it is intended.**

Such is the statement of the Department's position, and it is strictly adhered to by both the auditing and the investigating officers under whose scrutiny returns of income must pass. It is a general regulation with respect to all physical property employed in business.

There will, however, arise problems that cannot be solved by application of general rules. The percentage system is not a part of the law; it is merely prescribed by Departmental rules. And so, in circumstances when the rules are not applicable, it is suggested that the taxpayer may fall back upon the provision of law allowing a **reasonable deduction** for depreciation. If the taxpayer can show that his deduction is **reasonable,** he is within his legal rights, and cannot be penalized for asserting them.

266.—OBSOLESCENCE.

However, with respect to deterioration in value on account of obsolescence a different rule must be followed. That loss is sustained by such deterioration cannot be denied. Such a loss, however, is deductible as a loss and not according to the rule of annually claiming a year's percentage of the cost of the property. Regarding a loss of this kind the Department has plainly stated its position as follows:

> **It is not possible in advance to determine when a piece of machinery, equipment, or even a building will become obsolete. In other words, obsolescence cannot be anticipated and an annual deduction to take care of possible obsolescence cannot be allowed.**
>
> **The rules of this office contemplate that annual deductions for depreciation may be made to provide for loss due to wear and tear, the amount of such deduction to be determined upon the basis of the probable life of the property. If it shall occur that the property becomes obsolete or worthless before its estimated probable life shall have expired, a deduction representing the difference between the cost of the property and the amount previously charged off on account of depreciation may be deducted as a loss, this amount being a deduction due to the obsolescence of the property.**

267.—MUST APPEAR ON BOOKS.

There has been a great deal of controversy between taxpayers and the Government relative to a requirement in the rulings of the Treasury Department to the effect that the annual allowance for depreciation shall be charged off on the books of the taxpayer (corporation or individual) so as to constitute a liability against assets. Certain corporations have contended that there is nothing in the law—and that legally nothing can be written into departmental regula-

tions—requiring that a corporation keep its accounts by any particular method.

In extensive correspondence the Department has argued that the loss allowed for depreciation is supposed to be **a real loss,** and, as such, must, of reason, be taken regularly into the accounts of the taxpayer; that, if it is not a loss entitled to such consideration, it is not of the character that constitutes a legitimate deduction in a return of income. In effect, says the Department to the officers of a corporation, if the loss you claim on account of depreciation is not real enough to reflect to your stockholders, it is not real enough to have the approval of the Government as a charge against gross income.

And so the Department, in its instructions to field officers has ruled that where a claim for loss on account of depreciation is found to be reasonable but not to have been entered upon the books of the taxpayer, opportunity should be given the taxpayer to reopen the books and make proper entries to the end that the amount of the annual depreciation shall constitute a liability against the assets of the taxpayer and a charge against the income of the year for which the return is made. If the taxpayer refuses to make the proper entries, field officers are directed to disallow the amount claimed as a deduction on account of depreciation.

Moreover, the Department holds that a mere Journal entry is not sufficient, insisting upon a general ledger entry of the amount charged off and the reflection of the amount so charged in the annual Balance Sheet and in the report to stockholders.

268.—NO FIXED PERCENTAGES.

The law does not fix the annual percentage of depreciation with respect to any kind of physical property; neither do the regulations of the Department. But the Department does reserve to itself the right to pass upon the reasonableness of every deduction for depreciation under the requirement of the statute that the deduction shall be for a "reasonable allowance."

And, likewise, the taxpayer has a right to express his opinion with regard to what is reasonable.

The estimated life of the property (the probable number of years it will remain so as to be usable for the general purposes for which it was intended) is one consideration; the other, the cost.

Only so far do the regulations of the Department go.

During the early years of income tax administration certain estimated percentages of depreciation announced by the San Francisco

Real Estate Board were followed by Internal Revenue Officers in checking returns filed in California, and were approved by the Treasury Department. However, when the Department began the final audit of the returns filed for the year 1915 it reduced the percentage claimed by a great many taxpayers—reduced the percentage, in numerous cases, until the allowance was rankly unreasonable, as far as the rights of the taxpayer were concerned.

The estimated rates of depreciation fixed by the San Francisco Real Estate Board, above referred to, are as follows:

Class A buildings	**2 per cent per annum.**
" B "	**2½ per cent per annum.**
" C "	**3½ per cent per annum.**

269.—SUGGESTION TO TAXPAYER.

It is suggested that the taxpayer, bearing in mind the factors of cost and probable life, claim what seems right and fair and "reasonable." **There can be no penalty imposed for such an assertion of what one believes to be his right.** Subsequently the Department may disagree and disapprove, but even then the taxpayer still has the right of argument.

If the deduction on account of depreciation is reduced by the Department to an amount so small as to appear to the taxpayer unreasonable, and if as a result of the alteration of the return increased assessment is made, the taxpayer may again present his contention in the form of a claim for the abatement of the assessment. (See "Claims for Abatement and Refund.")

270.—COURT DEFINITION OF DEPRECIATION.

In order that the taxpayer may have the benefit of a judicial statement on this subject the opinion of the Court in the case of Hyman Cohen v. John Z. Lowe, Collector, in the District Court of the United States for the Southern District of New York (234 Fed. 474) is herewith quoted. Said the Court:

> The plaintiff was allowed 3 per cent for depreciation on an apartment house owned by him. This allowance is for the wear and tear suffered by the building during the tax year, which means the physical deterioration that the building suffered during that period. It does not take into account depreciation in value due to a loss in rental value because of the construction of more modern buildings with improved facilities, or due to a change in the neighborhood. It is to be based upon the life of the building in the sense of the number of years the building would remain in a condition to be habitable for the use for which it was constructed and used, and which was in the instant case for an apartment house, and not merely the number of years it would

> **stand without being condemned and torn down.** The annual depreciation would be an amount represented by a fraction having one (tax year) for the numerator and the number of years, representing the ascertained life of the building, as the denominator. This assumes that there would be an average deterioration suffered each year during the life of the building, and that the plaintiff would keep the building in good repair during the life of it. This the law exacts of him. Upon these assumptions, and giving this meaning to the words of the Statute, "a reasonable allowance for the exhaustion, wear and tear of the property, arising out of its use or employment in the business," the amount of the deduction allowed by the Government to the plaintiff on this account is deemed to be reasonable.

271.—NO DEPRECIATION OF REAL ESTATE.

The Treasury Department does not allow a deduction from gross income for depreciation of real estate. Real estate, it holds, is not property of the character affected by use, wear and tear. The life of it runs on forever.

True, as in the case of farming land which is intensively cultivated, productivity will decrease unless there be a replenishment of certain elements exhausted from the soil, but, as every farmer knows, this replenishment is accomplished by the rotation of crops, the growth and plowing under without harvest of plants rich in the weakening elements, or by the use of fertilizers; and when renewal and restoration are effected by plowing under of plants or the use of fertilizers, the cost of the operation and of the seeds and fertilizing materials used is deductible as an expense of operation. Consequently, deduction cannot be claimed for depreciation of the land.

In the case of improved property, that is real estate with buildings on it, some difficulty is experienced in certain circumstances. A case in point would be the purchase of a business building and the land on which it stands for $250,000, without any division of the purchase price being made at the time of purchase with respect to the cost of the building and the cost of the land. The Department would allow depreciation for the building but not for the land. It becomes necessary, therefore, to make a division with respect to cost, arbitrary, in a sense, but based upon the best available information.

272.—DEPRECIATION OF LIVESTOCK.

Depreciation is allowed for livestock employed in business. This provision covers the working horses and mules used on a farm, or in the livery or draying and delivery business—in fact, in any business where the working of animals is a part of the operation of the business—also stock used for breeding purposes.

In this connection, the Department has held in official letters dealing with individual cases that depreciation on animals used for business purposes is an allowable deduction provided the animals were not

raised by the owner of the business subsequent to January 1, 1913. If raised subsequent to that date, the cost of production will be covered by deductions for necessary expenses of operation of the business. In the case of animals raised by the individual prior to January 1, 1913, depreciation should be computed on the fair market value as of that date, holds the Department, while, in the case of animals purchased either before or after January 1, 1913, depreciation should be based upon cost.

273.—DEPRECIATION OF TREES AND VINES.

Deduction for depreciation is also allowed the owner of an orchard or a vineyard on account of the exhaustion of his trees or vines. The method outlined by the Department in letters dealing with individual cases can be stated, briefly as follows:

Until an orchard or a vineyard reaches a productive stage the expenditures in connection with it represent investment of capital and no deduction in connection with such property should be taken up to that time. But when the orchard or vineyard reaches a productive stage, it is proper to ascertain the cost of the trees or vines as represented by the investment in them up to that time. This cost, or investment, is to be ascertained by taking into consideration the purchase price of the trees or vines at the time of setting them out and all the carrying charges up to the time of bringing them to a productive stage. The cost thus determined is the basis on which to compute depreciation, the percentage of annual allowance to be calculated according to the average life of the trees or vines.

Experience has shown that trees vary widely with respect to length of life. A pear or an apple tree, or almond or cherry tree will last for a much longer time than a peach or apricot or prune or plum tree; and, likewise one kind of vine will live and produce many years longer than another. No exact span of life can be fixed. The farmer can draw upon his own experience, and that of others, and not be far from accuracy in estimating the life of his orchard or vineyard. This general method is readily adaptable to any kind of fruit, grape, berry or nut farming.

274.—DEPRECIATION OF PATENTS.

Allowance for depreciation of patents can be computed without difficulty. A patent is good for seventeen years. Therefore, if it remains the property of the patentee, or is acquired by another immediately after having been granted, its life is seventeen years. If it is acquired by another than the patentee after a part of its period of ex-

clusive rights has expired, its life, insofar as investment of capital is concerned, is the remaining portion of the seventeen-year period.

The cost of a patent to the patentee is the amount actually expended in perfecting the invention and obtaining the patent—such expenditures, for instance, as the cost of drawing, experiments, construction of models, and the fees, private or official, incident to application for the patent.

The cost of a patent to one (individual or corporation) who acquires it from the patentee is the amount actually paid for it.

An example of the operation of the above methods of computation:

A patents a mechanical device and expends in perfecting his invention and obtaining patent the total amount of $17,000. He is entitled to deduction for depreciation to the amount of $1,000 a year.

But if A buys from B a patent obtained seven years before by B and pays B $17,000 for the patent, A is entitled to deduct one-tenth of the amount of $17,000, or $1,700 a year on account of depreciation.

275.—NO DEPRECIATION OF SECURITIES.

Shrinkage in the value of securities is not deductible as depreciation. The allowance for deduction on account of depreciation has reference only to those kinds of tangible property subject to exhaustion, wear and tear as a result of use in business. Stocks, bonds and similar securities do not come within such a classification.

As explained, hereinbefore, with respect to losses on stocks and bonds, such losses are deductible in whole or in part, or not at all, **as losses,** and then only when the transaction in them meets the requirements set forth in detail in paragraphs dealing with deductions for losses. [See such paragraphs.]

276.—NO DEPRECIATION OF MERCHANDISE.

Also the Treasury Department holds that depreciation should not be claimed on merchandise by a taxpayer engaged in the mercantile business. Any deterioration in the value of a stock of goods, the Department has held in the course of its investigation of returns, may be reflected in the merchant's inventory from year to year and, therefore, is not a proper deduction on account of depreciation.

277.—NO DEPRECIATION OF GOOD WILL.

No deduction can be claimed for depreciation on account of the "good will" of a business. "Good will" must be eliminated from consideration. While it undoubtedly has a value, it is held to be such an intangible asset that it cannot be depreciated, as physical property is depreciated, for the purposes of the income tax. When it is one of the

assets of a business such value is over and above the value of the physical property used in the business.

278.—WHEN A CORPORATION REORGANIZES.

If upon reorganization one corporation buys and takes over the assets of another corporation, and issues its own capital stock in payment for such assets, the actual value of the property acquired, and not the nominal par value of the stock issued in payment for it, is regarded as the cost to be returned by allowances for depreciation. An example: Corporation A decides to effect reorganization by selling and transfering to Corporation B (having the same stockholders) all of its assets, such assets having an actual value of $100,000. Corporation B issues in payment therefor stock of the nominal par value of $500,000. In such circumstances the cost of the property to Corporation B is $100,000, and not $500,000.

In such a case the $500,000 par value in stock issued has, in reality, no greater value than the assets of a value of $100,000, which, as the property of Corporation B, will support the corporation's stock issue.

279.—INVESTMENT OF DEPRECIATION RESERVE.

The problem of dealing with the funds represented by depreciation reserve has seemingly given the Treasury Department a good deal of concern, for there has been a distinct reversal of its rulings, as announced in the first regulations issued after the enactment of the Income Tax law of October 3, 1913. The position originally taken by the Department was that the diversion of any portion of the depreciation set up to any purpose other than making good the loss sustained on account of depreciation would necessitate a return for tax of the amount diverted. Later in Treasury Decision 2137, this ruling was amplified by a regulation to the effect that the investment of depreciation reserve funds in additions to or extensions of the taxpayer's plant would be, specifically, such a prohibited diversion and would result in the requirement that the additional value given to the capital assets by such investment be returned as income subject to tax.

Then in official correspondence the Department modified its prohibition of investment in additions and betterments and took the position that the investment of depreciation reserve funds in additions and betterments should be regarded as a conversion of the funds into assets of another form rather than a diversion of them, and that, in the event the property with respect to which the depreciation reserve was set up is to be renewed or replaced, the cost of such renewal or replacement must be paid out of capital as distinguished from earnings.

Thus the Department decided to allow the investment of the depreciation reserve funds in additions and betterments to the extent that the amount so invested should remain a liability against the assets of the taxpayer and be available, through conversion into cash, by bond issue or otherwise, to renew or replace the property with respect to which the depreciation reserve fund was set up. With the obvious purpose of putting its meaning into one concise statement the Department on April 20, 1915, ruled as follows:

> The true intent and meaning of both the original and amplified rulings is that the depreciation reserve set up shall be a fair and reasonable measure of the loss due to use, wear and tear, shall be so entered on the books as to constitute a liability against the assets of the company (or other taxpayer) and shall be available to make good the depreciation claimed.

The early treatment of this subject has been briefly sketched so that the taxpayer may the more readily grasp the meaning of the **present controlling ruling,** to be found in Treasury Decision 2481, issued April 10, 1917, and herewith quoted as follows:

> The "second" paragraph under Sec. 12 of Title I of the Act of September 8, 1916, authorizes corporations, joint-stock companies, etc., in making their returns of annual net income to deduct from gross income——
>
> all losses actually sustained and **charged off** within the year * * * * * including a reasonable allowance for the exhaustion, wear and tear of property, arising out of its use or employment in the business or trade."
>
> The essential requirements of this provision are that the amount deductible on account of depreciation and depletion shall be **charged off** and shall be reasonable allowances—that is, an amount sufficient to make good the loss due to these causes. The phrase "charged off" contemplates that the "reasonable allowance" deducted from gross income on account of depreciation or depletion shall be credited to appropriate reserve accounts and carried as a liability against the assets, to the end that when the total of these credits equals the capital investment account, no further deductions on these accounts will be allowed.
>
> While the presumption is that amounts credited to these accounts will be used to make good the loss sustained, either through a renewal or replacement of the property or a return of capital, **there is no requirement of law that the funds represented by these reserve liabilities shall be held intact or remain idle** against the day when they may be used in making good the depreciation of the property with respect to which the deduction is claimed, or in restoring the capital invested in the depleted assets.
>
> **The conversion of the depreciation reserve into tangible assets will not constitute such a diversion as would deny the corporation the right of deduction, provided in all cases, that the deduction claimed in the return is a reasonable allowance, that is, a fair measure of the loss due to "exhaustion, wear and tear of property, growing out of its use" and is charged off or so entered upon the books as to constitute a liability against the assets with respect to which the depreciation deduction is claimed.**

CHAPTER XVIII

THE INCOME TAX

DEPLETION OF NATURAL DEPOSITS

280.—DEPLETION DEFINED.

The Income Tax law also recognizes the loss due to depletion of natural deposits in the case of certain kinds of property and makes specific provision for taking care of such loss and thereby returning to the taxpayer the capital investment in the natural deposits which are in the end supposed to be exhausted by the operation of the properties.

Commonly, such properties are wells, tapping supplies of oil or gas, and mines, containing mineral deposits in solid form. As production proceeds, it is obvious that, in the one case the oil or the gas flow naturally diminishes and that, in the other, there must come a time when the ore will all have been extracted. And so the law allows for deduction from gross income on account of such depletion of deposits.

This allowance is entirely separate and distinct from that covering depreciation of physical property. In other words, the terms **"depreciation"** and **"depletion"** must not be confused. The allowances are computed differently, and one has no relation to the other except insofar as both represent a return of capital investment.

281.—WHAT THE LAW SAYS.

In the language of the law deduction can be claimed for

(a) in the case of oil and gas wells a reasonable allowance for actual reduction in flow and production to be ascertained not by the flush flow, but by the settled production, or regular flow;

(b) in the case of mines a reasonable allowance for depletion thereof not to exceed the market value in the mine of the product thereof which has been mined and sold during the year for which the return and computation are made,

such reasonable allowance to be made in the case of both (a) and

(b) under rules and regulations to be prescribed by the Secretary of the Treasury;

Provided, That when the allowance authorized in (a) and (b) shall equal the capital originally invested, or, in the case of purchase made prior to March 1, 1913, the fair market value as of that date, no further allowance shall be made.

282.—CAPITAL TO BE RETURNED.

From a careful reading of the above quotation from the law it will appear that the amount of capital to be returned by allowance for depletion depends on the date of acquisition of the property.

(a) **If the property was acquired prior to March 1, 1913, the fair market value,** as of that date, represents the capital eventually to be returned by annual deductions.

(b) **If the property has been acquired within the period of time beginning March 1, 1913, the cost** represents the capital eventually to be returned by annual deductions.

And by "fair market value" and "cost" are meant the fair market value and cost of the natural deposits with respect to the depletion of which deduction is claimed.

283.—DEPLETION OF OIL OR GAS.

It has been deemed advisable here to print in full the regulations made by the Treasury Department under date of February 8, 1917, in Treasury Decision 2447, relative to allowances for depletion of oil and gas. An arbitrary system of inserting subheadings has been introduced in order that attention may be the more readily directed to the various provisions of the decision. After quoting the law making provision for deduction for depletion, the Department directs as follows:

Applies to Owners.

The purpose of this provision is to afford a means whereby the individual or corporation owning oil or gas producing properties may, during the period of operation, deduct from gross income the cost of, or capital actually invested, in the natural deposits, if the investment was made subsequent to March 1, 1913, or the fair market value as of March 1, 1913, if purchased prior to that date, the measure of the deduction being the reduction in the flow and production.

Must Be Reasonable.

The annual deduction must be reasonable and not in excess of such a percentage of the cost or value as the case may be and as herein defined, of the oil or gas producing properties as is indicated by the reduction in the original flow or settled production of one year as compared with that of the preceding year.

By Individual Well or By Group.

For the purpose of this deduction note may be taken of the reduction in flow and production of such individual wells as were producing

oil or gas during or at some time within the year, of groups of wells or of all wells in the field or territory embraced in the same ownership. If tested by the aggregate flow of all of the wells in the field or territory, owned by an individual or corporation and new wells shall have been developed during the year, it is possible that at the end of the year there will have been no reduction in flow and production, in which case, under the specific provision of the law hereinbefore quoted and under which the depletion deduction is measured by the reduction in flow and production, there can be no deduction for depletion.

Hence in the case of a field or territory in course of development or in which new wells are being drilled, if the depletion deduction is to be availed of in the returns of annual net income, each individual well or possibly each group of wells in operation at the beginning of, or brought in during the year, if the flow and production of the group of wells is so assembled as to be tested, must be tested at the end of the year in order that the decline in the flow and production may be determined.

New Wells or New Groups.

New wells or new groups of wells brought in during the year may be tested as soon as they have reached the stage of settled production or regular flow, and then again at the end of the year. The decline in flow and production, if any, as indicated by these tests, will be reduced to a percentage basis and a like percentage of the capital invested in the oil or gas property (exclusive of machinery, equipment, etc.) will constitute an allowable deduction from the gross income of the year on account of depletion. **Thus if the decline in the flow and production during the year of, say, ten wells, costing $100,000 has been 5% as compared with the production and flow as indicated by a test made at the beginning of the period, then 5% of $100,000 or $5,000** will, for the year for which the computation is made, constitute an allowable depletion deduction in favor of the individual or corporation owning and operating the property.

When Wells Cannot Be Grouped.

If the wells are not so situated that their flow and production may be assembled in order to test and ascertain the reduction in the output as a basis for computing depletion, it will be necessary for the corporation or individual owning the property and claiming a depletion deduction, to take an accurate gauge of the production and flow of each well at a certain same period of each year, and by comparing this gauge with that of the previous year, determine the percentage by which the production and flow has been reduced. This having been done as to all of the wells in operation, an average percentage rate of reduction in flow and production will be ascertained, and this rate will be applied to the capital invested, that is, the value of the oil or gas property as of March 1, 1913, or the cost of the same, if acquired subsequent to that date, for the purpose of determining the amount which may be allowably deducted from gross income by such owning individual or corporation, on account of depletion.

In Fully Developed Field.

In case of a field or territory fully developed and in which no new wells are being drilled, a comparison of the quantity of oil or gas produced during the year for which the computation is made with the quantity produced during the last preceding year, will disclose the reduction, and the percentage thus indicated of the reduction in flow and production of such field, will be the measure of the depletion deduction to be taken by the owner with respect to the capital invested in such field.

Flow of Unit Controls.

Notwithstanding the fact that the drilling of new wells may offset the reduction in the production and flow of the older wells in the field not fully developed, the provision of the law hereinbefore quoted, does not authorize, and this office cannot permit, a depletion deduction to be taken so long as the flow and production of the unit, be it a well or group of wells, or the entire territory, is as great during the year for which the return is made as it was for the year immediately preceding.

An Example of Depletion.

Illustrating in a general way the above rule as applied to a field or territory, the case may be taken of an oil property in which the capital invested, either actual cost or fair market value as the case may be, is $500,000 and the production during the year for which the return is made was 47,500 barrels, and for the year immediately preceding 50,000 barrels. This would indicate a reduction in production of 2,500 barrels, or a decline of 5%. Applying this rate to the capital, $500,000, the individual or corporation owning the property would be entitled to deduct from gross income as depletion for the year for which the return is made, the sum of $25,000, that is 5% of the invested capital.

Percentage of Unextinguished Capital.

The depletion deduction in all cases until the capital invested is extinguished, will be such a percentage of the unextinguished capital as the reduction in flow or production of one year is a percentage of the flow or production of the previous year.

Regarding Fair Market Value.

The estimate of the fair market value of gas and oil properties as of March 1, 1913, on which depletion deductions are based shall be the price at which the property as an entirety might have been sold for cash or its equivalent as of that date. The value hereinbefore contemplated must naturally be determined by each individual or corporation interested and who is the owner of the property, upon such basis as will not comprehend any operating profits, the estimated value in all cases to be subject to the approval of the Commissioner of Internal Revenue.

Ledger Account Required.

Every individual or corporation entitled to a deduction for depletion on account of reduction in flow or production of oil or gas shall keep an accurate ledger account, in which shall be charged the fair market value as of March 1, 1913, or the cost, if the property was acquired subsequent to that date, of the property whose value declines with the removal of the natural deposits. This account shall be credited with the amount of the depletion deduction claimed and allowed each year, to the end that when the credits to the account equal the debits, no further deduction for depletion with respect to this propery and the capital invested in it, will be allowed.

Cannot Revise Valuation.

The value determined and set up as of March 1, 1913, or the cost of the property if acquired subsequent to that date, will be the basis for determining the depletion deduction for all subsequent years during the ownership under which the value was fixed, and during such ownership there can be no revaluation for the purpose of this deduction if it should be found that the estimated quantity of oil or gas contained in the property was under-stated at the time the value was fixed or at the time the property was acquired.

The Lessee's Rights.

The provision of the law authorizing the depletion deduction, designed as it is to provide a means whereby the invested capital of an individual or corporation may not be subject to the tax imposed by this Title, does not apply to individuals or corporations who are operating oil or gas properties under lease, since in those cases the operator has no capital invested in such properties. By capital invested, as herein used, is meant the fair market value of the properties as of March 1, 1913, if acquired prior to that date, or the actual cost if acquired subsequent to that date, as it relates to the owner in fee of the properties.

Lessees will, however, be permitted to deduct from gross income each year, a reasonable allowance for depreciation, which depreciation applies to the physical property including rigs, tools, machinery of all kinds, pipes, casing, and other equipment necessary to the operation of the wells or field. If lessees, in order to secure the right to enter upon, explore, develop, or operate gas or oil properties, paid or shall pay, a bonus in addition to royalties, the amount of such bonus so paid, may be ratably distributed over the life of the lease or over the productive life of the property, and the lessee may deduct annually as a rental payment, an aliquot part of the amount of the bonus so paid, until such amount has been extinguished.

Expense of Drilling.

The incidental expenses of drilling wells, that is such expenses as are paid for wages, fuel, repairs, etc., which do not necessarily enter into and form a part of the capital invested or property account, may, at the option of the individual or corporation owning and operating the property, be charged to property account subject to depreciation, or be deducted from gross income as an operating expense. If, in exercising the option, the operating individual or company charged the expense of drilling wells to property account, the same may be taken into account in determining a reasonable allowance for depreciation during each year, until the property account thus augumented has been extinguished through annual depreciation deductions, after which no further deduction on this account will be permitted. The cost of drilling dry or non-productive wells may be deducted from gross income as a loss.

Must Furnish Information.

To each return made by an individual or corporation owning and operating oil or gas properties, there should be attached a statement showing (1) (a) the fair market value of the property (exclusive of machinery, equipment, etc.) as of March 1, 1913, if acquired prior to that date, or (b) the actual cost of the property if acquired subsequent to that date; (2) how the fair market value of the property as of March 1, 1913, was ascertained; (3) the quantity of oil or gas produced during the year for which the return was made; (4) the quantity produced during the year immediately preceding; (5) how the depletion deduction claimed in the return was computed, whether upon the decline in flow and production of individual wells, groups of wells, or the entire field; and (6) any other data which would be helpful in determining the reasonableness of the depletion deduction claimed in the return.

If the operator is a lessee, that fact should be stated and an explanation given as to the basis and property upon which any depreciation deduction is claimed, it being understood as hereinbefore indicated, that depreciation relates to the loss due to the use, wear and tear of physical property, and that the lessee is not entitled to any deduction for the depletion or exhaustion of the oil or gas deposits, but may deduct annually as a rental payment, an aliquot part of any bonus paid for the right to enter upon, explore, develop and operate oil or gas territory as well as the royalty payments made to the lessor for the oil or

gas removed from such property, provided the entire proceeds from the oil or gas produced during the year are returned in the gross income of the operator.

No Other Rule Applies.

The above rule for computing allowable depletion deductions being set out in the law, no deduction on this account will be allowed if computed upon any basis other than that authorized by the law and further amplified in this decision.

284.—DEPLETION OF MINES.

Deduction for depletion of ore deposits in mines is calculated according to an entirely different method—a method which in certain circumstances, the Treasury Department frankly admits, must be based upon probable value. The mine owner, however, either has knowledge of mining engineering himself or commands the professional services of engineers; hence the problem of determining the value and extent of an ore deposit en bloc will not appear to him as perplexing as it does to the layman.

Again it has been deemed advisable to quote the language of the Department's regulations, based upon the Act of September 8, 1916, and issued in Treasury Decision 2446 on February 7, 1917. For the convenience of the reader subheadings have been arbitrarily inserted. The Department directs as follows:

Ownership Essential.

Ownership of the mine content at the time for which the computation is made, is an essential pre-requisite to an allowable deduction.

Distinct From Depreciation.

The law authorizes in the case of mines, two classes of deductions to take care of the wasting of assets, namely, (a) depreciation, (b) depletion.

Depreciation comprehends loss due to exhaustion, wear and tear of physical property, other than natural deposits, and the annual allowance contemplated by this Title on this account, will be ascertained by spreading ratably the cost of the property over the probable number of years constituting its life.

In determining the amount of depreciation deductible in the case of buildings, the cost or value of the land upon which the buildings are situated, will be excluded and will not be considered a part of the original capital to be extinguished through depreciation deductions. The amount to be taken care of through depreciation deductions applicable to physical property other than natural deposits, will always be the capital invested in it, and not a value which may be arbitrarily fixed as of March 1, 1913, or as of any other date.

Must Get Value En Bloc.

In case of mines (other than oil and gas wells), if the property was acquired prior to March 1, 1913, the amount of invested capital which may be extinguished through annual depletion deductions from gross income, will be the fair market value of the mine property as of March

1, 1913. The value contemplated herein as the basis for depletion deductions, authorized by this Title, must not be based upon the assumed salable value of the output under current operative conditions less cost of production, for the reason that the value under such conditions would comprehend the earning capacity of the property.

Neither must the value determined as of March 1, 1913, be speculative, but must be determined upon the basis of the salable value en bloc as of that date, of the entire deposit of minerals contained in the property owned, exclusive of the improvements and development work; that is, the price at which the natural deposits or mineral property as an entirety in its then condition, could have been disposed of for cash or its equivalent.

Depletion Measured By Unit.

The value en bloc having been thus ascertained, an estimate of the number of units (tons, pounds, etc.) should be made. The en bloc value divided by the estimated number of units in the mine or mining property will determine the per unit value, which, multiplied by the number of units mined and sold during any one year, will determine the sum which will constitute an allowable deduction from the gross income of that year on account of depletion.

Deductions computed on a like basis may be made from year to year during the ownership under which the value was determined, until the aggregate en bloc value as of March 1, 1913, of the mine or mineral deposits shall have been extinguished, after which no further deduction on account of depletion with respect to this property, will be allowed to the individual or corporation under whose ownership the en bloc value was determined.

The precise detailed manner in which the estimated fair market value of mineral deposits as of March 1, 1913, shall be made must naturally be determined by each individual or corporation interested, and who is the owner thereof, upon such basis as **must not comprehend any operating profits,** the estimate in all cases to be subject to the approval of the Commissioner of Internal Revenue.

Ledger Account Required.

Every individual or corporation claiming and making a deduction for depletion of natural deposits shall keep an accurate ledger account, in which shall be charged the fair market value as of March 1, 1913, or the cost, if the property was acquired subsequent to that date, of the mineral deposits involved. This account shall be credited with the amount of the depletion deduction claimed and allowed each year, to the end that when the credits to the account equal the debits, no further deduction for depletion with respect to this property will be allowed.

Cannot Revise Valuation.

The value determined and set up as of March 1, 1913, or the cost of the property if acquired subsequent to that date, will be the basis for determining the depletion deduction for all subsequent years during the ownership under which the value was fixed, and during such ownership, there can be no re-valuation for the purpose of this deduction, if it should be found that the estimated quantity of the mineral deposit was understated at the time the value was fixed or at the time the property was acquired.

When Data Is Lacking.

In cases wherein the quantity of the mineral deposit in the mine prior to March 1, 1913, cannot be estimated with any degree of accuracy, it will be necessary, if depletion deductions are to be availed of,

for the individual or corporation owning the deposits, with the best information available, to arrive at the fair market value of the property as of March 1, 1913, that is, its fair cash value en bloc if such value is believed to be other than its original cost, which value, during the period of the ownership under which it was determined, shall be final, and shall be charged to the property account as hereinbefore indicated, and then, on the basis of the most probable number of units in the property, the per unit value shall be determined as the basis for computing annual depletion allowances, this method and allowances to be continued until, but not beyond, the time when the value as of March 1, 1913, shall have been extinguished.

The original cost of the mineral deposit may be taken as the basis for computing annual depletion deductions if the fair market value as of March 1, 1913, as hereinbefore required, cannot be ascertained otherwise, allowance being made for minerals which may have been removed prior to that date.

Acquired on or After March 1, 1913.

In cases wherein a mine or mineral property was acquired subsequent to March 1, 1913, the same rule for computing the annual depletion deduction will apply except that in such case the basis of the computation will be the actual cost rather than the value as of March 1, 1913.

The Lessee's Rights.

The foregoing rules apply to owners in fee of mines and mining properties and do not contemplate that an individual or corporation operating a mine under lease on a royalty basis, shall be entitled to any deduction for depletion. If, however, the lessee, in addition to royalties, paid or pays a stipulated sum for the right to explore, develop and operate a mine, the amount so paid may be ratably distributed over the life of the lease or the probable life of the mine under ordinary operating conditions, and the lessee may deduct annually as a rental payment, an aliquot part of the amount of the bonus so paid, until such amount has been extinguished.

Must Furnish Information.

To the return made pursuant to the above rule, there should be attached a statement setting out (1) whether the operator is a fee owner or lessee; (2) in the case of a fee owner, (a) the fair market value of the mineral deposits as of March 1, 1913, if the property was acquired prior to that date, (b) the cost of the mineral property if acquired subsequent to that date; (3) the method by which the value as of March 1, 1913, was determined in case the property was acquired prior to that date; (4) the estimated quantity in units in the mine as of March 1, 1913, or at the date of purchase if acquired subsequent to that date; (5) the number of units removed and sold during the year for which the return was made; and (6) any other data which would be helpful in determining the reasonableness of the depletion deduction claimed in the return.

In the case of a lessee, the statement should show (a) the amount of the bonus or other payment made for the right to operate the mine; (b) the period covered by the lease.

285.—WHEN PROBABILITIES CONTROL.

Referring to the fourth paragraph back under the heading **"When Data Is Lacking,"** it can only be suggested here that the mine owner make a conscientious effort to comply with the spirit of the

law and submit the case with an explanation to the Treasury Department for its judgment. In such circumstances, frankness on the part of the mine owner will contribute materially to the solution of the problem.

CHAPTER XIX

THE INCOME TAX

FILING OF CORPORATION RETURN.

286.—PERIOD COVERED.

A corporation can base its return upon either the calendar year or its own fiscal year. This is a privilege not extended individuals.

Except in the case of new corporations, or corporations that go out of business and dissolve, or corporations changing from the calendar-year to the fiscal-year basis, a return must be for a twelve-months' period. And, except in the case of a corporation dissolving and closing its affairs by filing a final return, a return must be for a period closing with the last day of some month—the last day of December if filed for the calendar year, or the last day of some other month if filed for a fiscal year differing from the calendar year.

It is immaterial to the Government whether a corporation file return for the calendar or its own fiscal year. But if return is to be filed for its own fiscal year, a corporation must comply with certain specific requirements.

287.—FISCAL-YEAR RETURN.

A Collector of Internal Revenue is not allowed to accept a return made for a fiscal year unless the corporation offering it has followed precisely the rules laid down for establishing the right so to file instead of on the basis of the calendar year. As simply as possible these rules will be explained.

The corporation must give notice in writing to the Collector of Internal Revenue of its desire to file upon the basis of a fiscal year and in such notice must designate the **last day** of some month as the close of its fiscal year.

This notice must be in the hands of the Collector **not less than thirty days prior to March 1, of the year in which the desired fiscal year period of twelve months closes.**

The notice having been given, as just explained, the corporation will, **on or before March 1,** file a return for that portion of the preceding calendar year that elapsed before the beginning of the fiscal year period of twelve months on which it is desired hereafter to file return. This is to clear up the business of the corporation with the Government to the beginning of its fiscal year.

Next, having filed return for the portion of the preceding calendar year that elapsed before the beginning of its fiscal year, the corporation will wait until its fiscal year closes, as designated in the notice to the Collector, and thereafter will, **within sixty days of the close of such fiscal year,** file a return for the full fiscal year period.

The above will not appear so complicated if studied according to the following illustrations:

A corporation, which filed its return for the calendar year 1916, desires to change to a fiscal-year basis and, therefore, not file for the calendar year ending December 31, 1917. It desires to designate a fiscal year which, when first put into effect, will begin in the year 1917, but an end in the year 1918—suppose the proposed fiscal year be to end with the last day of August. The corporation cannot, however, under the law, cover more than twelve months in one return. It must proceed as follws: (1) Not less than thirty days prior to March 1, 1918, file with the Collector a written notice designating the last day of August as the close of its fiscal year and stating that return will be filed according to such fiscal year; (2) on or before March 1, 1918, file with the Collector a return of income for that part of the year 1917 beginning January 1 and ending August 31; (3) within sixty days after August 31, 1918 file a return of income for its fiscal year beginning September 1, 1917 and ending August 31, 1918; (4) thereafter, file each year for its full fiscal year within sixty days after the last day of August.

To the case of a corporation organized during the year 1917 and desirous of establishing a fiscal-year basis the example just given is readily adaptable.

Suppose the corporation was organized April 10, 1917 and did not, therefore, file a return for the calendar year 1916. It has no status in the Collector's office, except that information as to its organization has reached him and a return will be expected on or before March 1, 1918 for that part of the calendar year 1917 beginning April 10 and

ending December 31, unless the corporation itself take the initiative in establishing a fiscal-year basis. In such a case, should it desire a fiscal year ending with the last day of August, the new corporation would take the following course: (1) Not less than thirty days prior to March 1, 1918 file with the Collector a written notice designating the last day of August as the close of its fiscal year and stating that return will be filed according to such fiscal year; (2) on or before March 1, 1918 file with the Collector a return of income for that part of the year 1917 beginning April 10 and ending August 31; (3) within sixty days after August 31, 1918 file a return of income for its full fiscal year beginning September 1, 1917 and ending August 31, 1918; (4) thereafter file each year for its full fiscal year within sixty days after the last day of August.

Unless the foregoing instructions are followed a fiscal-year return will not be accepted.

The examples given show that a corporation may either begin its income-tax relations with the Government according to the fiscal-year method of filing return, or that it may change from a calendar-year to fiscal-year basis after having filed according to the calendar year.

It is essential that the last day of some month be designated as the close of a fiscal year. The Government will not recognize a fiscal year closing on any but the last day of a month.

288.—WHEN TO BE FILED.

A return for the calendar year must be filed on or before the first day of March of the following year—that is a return for the calendar year 1917 must be filed on or before March 1, 1918, and so on. **The first day of March is the last day of the filing period.**

A return for a corporation's fiscal year must be filed within sixty days after the close of such fiscal year. **The sixtieth day after the close of the fiscal year is the last day of the filing period in such a case.** [See instructions regarding "Fiscal Year Return."]

When the last day of the filing period falls on a Sunday or legal holiday, the last due date is the day following the Sunday or legal holiday.

289.—HOW FILED.

The filing of a return means the delivery of the return to the Collector of Internal Revenue. This must be accomplished by a corporation on or before the first day of March, in the case of a calendar-year

return, or within sixty days after the close of its fiscal year, in the case of a fiscal-year return. [Also see paragraph "How Filed" in instructions given individuals.]

A corporation's return should be signed and verified by two officers of the corporation—preferably by the President and Treasurer—but the signatures of such other responsible officers as the Vice-president and Secretary will be accepted if the President and Treasurer's signatures are not available. In some circumstances returns have been accepted with the signature of only one officer but this has not been strictly according to law. **The return must also, and in every instance, be sworn to** before an officer authorized to administer oaths. It can be sworn to before the Collector of Internal Revenue or one of his deputies.

290.—WHERE FILED.

A domestic corporation is required to file its return with the Collector of Internal Revenue of the district in which its principal office is located, and by "principal office" is meant the place where are kept its books of account. However, if the books of account of a domestic corporation are kept in a foreign country the return should be made in the district where it has its principal branch office in the United States.

A foreign corporation is required to file its return in the district where is located its principal place of business in the United States. If it has no such place of business, then it must file with the Collector of Internal Revenue at Baltimore, Md. (the district which includes the District of Columbia). If a foreign corporation has several branch offices in the United States, it should designate one of them as its principal place of business in this country.

291.—RECEIPT FOR RETURN.

Each corporation is entitled to a receipt from the Collector when it files its return and should ask for this evidence of filing as a protection against subsequent possible loss of the return. The Department has provided a form on which the receipt can be issued.

292.—FORM TO BE USED.

A corporation's return must be made on one of several prescribed forms to be obtained from the Collector of Internal Revenue by written or personal request. Certain corporations must use special forms; therefore, state in asking for a form in which of the following classes the corporation belongs:

(a) Corporations in general, other than insurance and steam-railroad corporations.

(b) Insurance corporations, including mutual life and mutual marine insurance corporations.

(c) Mutual Insurance corporations other than mutual life and mutual marine insurance corporations.

(d) Steam-railroad corporations.

293.—KEEP COPY OF RETURN.

And, as in the case of individuals, it is suggested that each corporation keep a copy of its return. Two copies of the return form should be requested so that the retained copy may be on the official form. If the extra copy of the official form cannot be obtained the copy of the return retained should be made on an improvised form.

294.—EXTENSION OF TIME.

An extension of time **not to exceed thirty days** from the time prescribed by law in which to file a return can be granted by a Collector of Internal Revenue when such extension is necessary because of the sickness or absence of an officer of the corporation who is required to verify its return. These reasons are the only ones that can be considered by the Collector.

An extension for **more than thirty days** can be granted by the Commissioner of Internal Revenue; in fact, the Commissioner can grant his extension for any reasonable time in any meritorious case.

If a 30-day extension is desired written application must be made for it to the Collector prior to the expiration of the period for which the extension is requested, and in this application the necessity for having the time for filing extended must be explained. This application does not have to be made on or before March 1. It can be made within the thirty days following March 1 (or within the thirty days after the end of the sixty-day period following the close of a fiscal year); in such case, however, the corporation officers should be sure that their reasons are adequate. If they are in doubt, the application for extension should be made in sufficient time to allow them to file the corporation's return on or before March 1, (or within sixty days after the close of the fiscal year) in the event of the refusal to grant the request for extension.

When an extension for more than thirty days is desired, the application should be made and facts stated in a letter to the Collector, who will transmit the request to the Commissioner at Washington for action. Time should, therefore, be allowed for reference to Washington.

When a return is filed at an extended date, the fact that the time has been extended should be noted on the margin, or by a rider attached.

The Commissioner at Washington has been liberal and considerate in extending the time in the case of non-resident alien individuals and corporations, and in the case of American citizens traveling abroad.

295.—TENTATIVE RETURN.

If circumstances make it impossible to file a complete return within the time prescribed by law, and if an extension of time has not been obtained, a corporation may file a **tentative or partial return,** and later substitute for it a complete return when it has been possible to assemble the necessary data. It is not necessary, however, for a corporation to avail itself of this privilege for when its case is meritorious (even though its reasons are not the sickness or absence of one of its officers) it can obtain an extension for any reasonable time from the Commissioner.

296.—SUPPLEMENTARY STATEMENT.

The **Supplementary Statement** is a part of a corporation's return of income and the demand for it has the backing of the law the same as has the return proper. Either the filling out of this statement or the substitution of another that will explain in as full detail how the corporation has arrived at its gross income and deductions is necessary. The Department prefers the use of the Supplementary Statement for which provision has been made on the official return form, but has not been unyielding in this respect. **Collectors have been instructed, however, not to accept a return** unless it is accompanied by some detailed Supplementary Statement giving all the information essential to the proper auditing of the return.

The Supplementary Statements of insurance companies must give data essential to the enforcement of the provisions of the law peculiarly applicable to such corporations. The requirements of the Department in this respect are as follows:

> All insurance companies should include and attach to their returns a supplementary statement showing, for life companies, the aggregate of items "of such portion of any actual premium received from any individual policyholder as shall have been paid back or credited to such individual policyholder, or treated as an abatement of premium of such individual policyholder within such year;" in the case of mutual fire insurance companies a statement showing "any portion of the premium deposits returned to their policyholders;" and in the case of mutual marine companies "amounts repaid to policyholders on account of premiums previously paid by them, and interest paid upon such amounts between the ascertainment thereof and the payment thereof," which are, or may be, omitted from gross income.

297.—INFORMATION AS TO EXEMPT INCOME.

The Supplementary Statement, while a part of the return of income. is not the basis of assessment of tax. It is essentially a statement of information. In it will be found a space requiring that holdings of United States, State and municipal bonds be listed. This requirement should be complied with although the income from such bonds does not enter into the computation of tax liability.

298.—WHEN NO RETURN IS FILED.

If a corporation's return is not received within the time presc ibed by law, or within the period covered by an extension of time, the Collector issues a notice of delinquency in filing and demand for a return. If a return is not filed within ten days from the date of this notice, it becomes the duty of the Collector to examine the books of the corporation and prepare a return, which can be taken as a legal basis of assessment, even without the signatures of officers of the corporation. It therefore, behooves a corporation to give immediate attention to such a notice, for the Collector has full authority of law to back it up with action.

Similar action can be taken by the Collector with respect to individuals who fail to file their returns according to law.

299.—CORRECTION OF A RETURN.

In this respect a corporation has the same rights as an individual. It is therefore suggested that the similar paragraph in instructions given individuals be consulted.

300.—PENALTY FOR NEGLECT TO FILE.

Punishment for neglect or refusal to file a return of income within the time prescribed by law, or covered by an extension, takes two forms—one a specific penalty of not to exceed $10,000, and the other an increase of the amount of tax found to be due by 50 per cent.

301.—PENALTY FOR FALSE RETURN.

In the case of the filing of a false return the specific penalty would remain the same, but the increase of tax found to be due would be to the extent of 100 per cent. Moreover, with respect to a false return, the officers of the corporation signing it could be prosecuted for perjury, or could be prosecuted under the amendment carried by the War Revenue Act, providing a fine not exceeding $2,000, a year in prison, or both.

302.—ON BASIS OTHER THAN RECEIPTS.

Ordinarily a corporation's return is to be based upon **income received and deductions actually paid out** during the year for which it is made. However, the law provides **that a corporation keeping accounts upon any basis other than that of actual receipts and disbursements may make its return upon the basis upon which its accounts are kept, provided such basis clearly reflects its income and comes within regulations prescribed by the Commissioner of Internal Revenue.**

The same provision is carried in the law with respect to the return of an individual whose system of accounting is not strictly according to actual receipts and disbursements.

[See paragraph on this subject in chapter on **"Miscellaneous Provisions, Income Tax."**]

CHAPTER XX

THE INCOME TAX

MISCELLANEOUS PROVISIONS
INCOME TAX

In this chapter special attention is given certain subjects which may be covered in other chapters. The reason for repetition and explanation in greater detail with respect to certain questions and problems that must arise is based upon an experience which has shown that they require emphasis.

303.—FIXING LIABILITY OF HUSBAND AND WIFE TO MAKE RETURN.

The law provides that only one specific exemption shall be claimed by husband and wife living together. This may be claimed in a joint return, or in whole by one in the case of separate returns, or may be divided between the two in the case of separate returns.

When husband and wife are living together and have separate estates they may make a joint return, but in such return the income of each must be separately stated and the names of both must be given. If a joint return is made **it need be signed only by the husband.**

If a wife, living with her husband, makes a separate return, her return should be attached to that filed by her husband.

If either husband or wife separately has a net income equal to or in excess of the specific exemption [under the Act of October 3, 1917, (War Income Tax), $2,000,] a return must be filed and such return must include the income of both.

If the aggregate net income of both exceeds the specific exemption (as stated in brackets in the preceding paragraph), a return of their combined incomes must be filed, although neither one separately may have a net income equal to the specific exemption.

If either a husband or a wife has separate income, or if both have separate incomes, sufficient in amount, considered separately, to be subject to the additional tax, it is suggested that they make separate returns. For, while the normal tax is levied upon combined income, the additional tax is assessed upon the income of each, alone.

In the case of the death of either husband or wife during the year, if the deceased had a net income for that part of the year prior to death equal to the amount of the specific exemption, a return of income must be made by the administrator or executor for the period beginning with January 1 and ending with the date of death, and in such return the administrator or executor can claim for the deceased a **full year's exemption.** The survivor (widow or widower) would, then, at the end of the calendar year have the status of a single person and would have to make separate return and be allowed specific exemption accordingly, unless the survivor be able to qualify as "head of a family," or have been married again prior to the end of the year on December 31. [Under the Act of October 3, 1917 (War Income Tax) every single person, citizen or resident of the United States, who is not the head of a family, is allowed a specific exemption of $1,000, and must make return if in receipt of net income of that amount or more.]

304.—TAX-FREE GUARANTY IN CORPORATION BONDS.

The holder of corporation bonds containing a clause to the effect that the interest shall be paid without deduction for any tax that may be assessed, must not conclude that by such clause income-tax liability with respect to the interest is transferred to the corporation which has issued the bonds. **On the contrary income-tax liability remains with the holder of the bonds.** To the holder of the bonds this interest is income, the same as any other kind of interest or other form of gain. The Treasury Department holds that the guaranty clause in the bond is a contract wholly between the corporation and the bondholder. The interest received on such bonds must be accounted for by the bondholders in their returns, either as income which has been taxed at the source or as income which has not been taxed at the source, **according to the form of ownership certificate used in presenting the interest coupons for payment.** Such income **is not always taxed at the source.** (See particularly and read carefully instructions on this point in chapter on "Deduction of Tax and Information at the Source."

If a domestic corporation owns such bonds, its income not being subject to tax at the source under the law, it must include the amount of such interest in full in its return, regardless of the guaranty in the bonds. It must pay the tax due on its total net income, **including such interest,** and can look for reimbursement only to the corporation which has issued the bonds.

305.—SPECIFIC EXEMPTION NOT ALLOWABLE FOR ADDITIONAL TAX.

The specific exemption is not allowable as a credit against net income in the computation of the additional tax. It applies only to the computation of the normal tax.

306.—DIVIDENDS NOT A CREDIT FOR ADDITIONAL TAX.

That part of an individual's income received in the form of dividends on the stock of corporations subject to tax, while deductible from net income as a credit in the computation of the normal tax, is not allowable as a credit in the computation of the additional tax.

307.—INCOME TAXED AT SOURCE NOT A CREDIT FOR ADDITIONAL TAX.

That part of an individual's income, if any, on which the normal tax has been deducted and withheld at the source, enters into the computation of the normal tax due directly from the individual, as a credit according to the amount of the deduction at the source. However, as no more than a normal tax can be deducted at the source in any circumstances, the income subjected to such deduction does not offer a credit in the computation of the additional tax.

308.—WHEN EARNINGS OF CORPORATION ARE HELD TO EVADE TAX.

The Act of September 8, 1916 provides against the accumulation of the earnings of a corporation without declaration of dividends in order that the individual stockholders may not have to include the amount of dividend payments in their respective returns. The taxable income of the individuals can be increased for the assessment of the additional tax by the shares of the corporation's earnings to which they are entitled, whether the earnings have been distributed or not, when it can be shown that the corporation has deferred distribution and allowed earnings to accumulate purposely to enable individual stockholders to evade payment of tax.

The fact that the corporation accumulating its earnings **is a mere holding company,** or that **any corporation** has accumulated its earnings **beyond the reasonable needs of its business,** will be considered prima facie evidence of fraudulent purpose, under the law. However, the fact that earnings are allowed to accumulate and become surplus is not to be taken as evidence of intent to evade tax **unless the Secretary of the Treasury holds that the accumulation is unreasonable** with respect to the needs of the business.

One of the amendments carried by the Act of October 3, 1917 also strikes at such accumulation by penalizing the corporation itself instead of the stockholders in the provision imposing an additional tax at the rate of 10 per cent upon the amount of a corporation's net income remaining undistributed six months after the close of the taxable year, provided such amount is not actually invested or employed in the business, or retained for the reasonable requirements of the business, or invested in obligations of the United States issued after September 1, 1917.

309.—PREVAILING RATES OF EXCHANGE FIX AMOUNT OF FOREIGN INCOME.

In the case of a citizen or resident of the United States, or of a domestic corporation, when income accruing from foreign investments is not remitted to the United States but is placed to the credit of the individual or corporation in a foreign country, each item of such income should be accounted for at the rate of exchange prevailing when it is credited to the account of the individual or corporation.

310.—INTEREST ACCRUED ON BONDS AT TIME OF PURCHASE.

In the case of a purchase of bonds between interest dates at a price covering not only the principal of the bonds but also the accrued interest thereon, the question arises: How is the purchaser to account for the interest as income when it is received by him in view of the fact that a part of it accrued while the bonds were under another ownership? The position of the Government is that the purchaser shall account in his return for that part of the interest payment which accrued under his ownership and that the person from whom he bought the bonds shall include in his return that part of the interest which accrued prior to the change in ownership of the bonds. As a matter of fact, the seller of the bonds in such a transaction would have received his share of the interest in advance when, in disposing

of the bonds, he was paid an amount covering both principal and accrued interest.

311.—BOOK APPRECIATION AND DEPRECIATION DO NOT CREATE INCOME AND LOSS.

Mere book adjustments of the value of assets in the accounts of an individual or corporation do not create either income or loss, within the meaning of the law. The writing down of retained assets does not constitute that kind of a completed and closed transaction which the Government insists shall occur before a loss can be claimed; and, conversely, **the writing up does not represent income.** While a book entry reflecting a reduced or an enhanced value of assets during the year may evidence a decrease or an increase in the net worth of the individual or corporation for that year, such decrease or increase, in the case of assets retained and under a possible change of conditions. may disappear the next year.

312.—SUIT TO RESTRAIN ASSESSMENT AND COLLECTION OF TAX CANNOT BE MAINTAINED.

Section 3224 of the Revised Statutes of the United States (applicable to all Federal taxes) reads as follows:

> No suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court.

This section of the general Federal law is specially applied to the income tax by Section 22 of the Act of September 8, 1916, reading as follows:

> That all administrative, special, and general provisions of law, including the laws in relation to the assessment, remission, collection, and refund of internal-revenue taxes not heretofore specifically repealed and not inconsistent with the provisions of this title, are hereby extended and made applicable to all the provisions of this title and to the tax herein imposed.

313.—SUIT TO RECOVER TAXES WRONGFULLY ASSESSED AND COLLECTED.

For information with respect to the procedure to be followed the reader is referred to paragraphs entitled **"Must Precede Suit to Recover"** and **"Two-year Limitation"** in chapter on **"Claims for Abatement and Refund of Taxes."**

314.—TAX MUST BE ASSESSED WITHIN THREE YEARS—WAIVERS.

The law provides that the Commissioner shall assess an income tax within three years after the return is due, in the case of neglect

or refusal to file a return or of the filing of an erroneous or false return. This means that in the case of an individual or a corporation that **should have filed but did not file** a return for the Calendar year 1916, or in the case of an individual or corporation that **did file** an erroneous or false return for that year, the due date of the return was March 1, 1917. In order to make assessment upon income for that year (1916) the Commissioner would have to learn of failure to file a return, or error or fraud in a return filed, in sufficient time to enable him to make assessment not later than the last day of February in the year 1920.

The courts have held, however, that there is no limitation upon the right of the Government to sue for and recover unpaid taxes, even though it is not possible to follow the usual method of assessment after the expiration of three years. It is not essential, therefore, that assessment be made. If liability to original or additional tax is discovered, the amount can be recovered by suit, regardless of the fact that no assessment has been made, and regardless of the date of the discovery of the liability.

Waiver of Limitation.

In view of the provisions of law, as just explained, the Treasury Department has instructed Internal Revenue field officers, whenever they discover tax liability too late for assessment within the three-year period, to request of the individual or corporation liable to tax the execution of a waiver of the statutory limitation. If such waiver is executed, the Department says, the tax will be assessed in the customary way; but, if not executed as requested, the Government will institute suit to collect.

315.—INCOME TO A STATE FROM A PUBLIC UTILITY.

The income that may be derived by any State, or political-subdivision of a State, or by the Territorial governments of Alaska and Hawaii, or by the insular governments of the Philippines and Porto Rico, is protected from assessment of tax by Subdivision (b) of Section 11 of the Act of September 8, 1916, which specifically provides that such income shall not be taxed and adds the provision that whenever any such governmental unit had, prior to the passage of the law (prior to September 8, 1916), entered into a contract with any person or corporation, (the object and purpose of which contract was "to acquire, construct, operate, or maintain a public utility,") the income of

the State, or other governmental unit resulting from the performance of the contract shall not be taxed. This provision is not to be construed, however, as exempting from tax the income accruing to the private contractor.

Interpreting the law, the Treasury Department holds in Treasury Decision 2090 that——

"where a portion of the net earnings of such public utility is payable under such contract to the State, Territory, etc., the amount so paid may be deducted by the public utility operating under such contract as an 'expense of business.'"

316.—WHEN RECORD OWNER OF STOCK IS NOT ACTUAL OWNER.

It frequently is true that stock is recorded in the name of a person or corporation when such person or corporation is not the actual owner and does not benefit by the dividends paid. In such a case, **provided the actual owner is a citizen or resident (individual) of the United States, or a domestic corporation,** the record owner simply ignores the payment of a dividend in making his or its return and the actual owner accounts for the dividend as income.

317.—INTEREST RECEIVED ON BONDS OF EXEMPT CORPORATIONS.

While the law specifically exempts from tax the income of certain classes of corporations of a general public, mutual, social, and fraternal character (see chapter on "Corporations Exempt"), **it does not exempt from tax the interest paid on bonds issued by such corporations.** This interest is not income of the exempt corporations; it is income of the bondholders and when such bondholders (individual or corporate) are otherwise taxable they must include the interest in their returns and subject it to tax. A case in point would be the interest paid on bonds of the California Country Club to John Doe. The club is exempt but John Doe is not; therefore John Doe includes the interest in his return.

318.—ACCOUNTS UPON BASIS OTHER THAN ACTUAL RECEIPTS AND DISBURSEMENTS.

It has been deemed advisable to refer again to those provisions of the Act of September 8, 1916 which give both an individual and a cor-

poration the right to make a return upon a basis other than one of actual receipts and disbursements during the year when the taxpayer's accounts are kept on some other basis.

The first condition to the enjoyment of this privilege is that the system of accounting shall reflect income; the second is that it shall be subject to regulations made by the Treasury Department. The question of regulations is, therefore, the question in which the taxpayer is interested.

The Department has been general and, necessarily indefinite, in its instructions. And, obviously, this attitute is essential to allowance of the leeway plainly intended by Congress.

"This office requires no special system of bookkeeping," says the Department in Treasury Decision 2161, "neither does it require any specific method by which the net income to be returned by corporations shall be determined."

Further in Article 158 of Regulations No. 33, it explains as follows:

"It is immaterial whether the deductions except for taxes and losses are evidenced by actual disbursements in cash, or whether evidenced in such other way as to be properly acknowledged by the corporate officers and so entered on the books of the corporation as to constitute a liability against the assets of the corporation making the return. Except as the same may be modified by the provisions of this Act, limiting certain deductions and authorizing others, the net income as returned for the purpose of the tax should be the same as that shown by the books or the annual balance sheet."

And in Article 183 of Regulations No. 33, the Department adds:

"The books of a corporation are assumed to reflect the facts as to its earnings, income, etc. Hence they will be taken as the best guide in determining the net income upon which the tax imposed by this Act is calculated. Except as the same may be modified by the provisions of the law, wherein certain deductions are limited, the net income disclosed by the books and verified by the annual balance sheet, or the annual report to stockholders, should be the same as that returned for taxation."

In Treasury Decision 2433, issued under date of January 8, 1917, are to be found the latest instructions from the Department. Even though these instructions, or regulations, have been elsewhere in this book referred to, it has been deemed advisable to give their requirements in full here. After quoting the provision of law authorizing the

filing of a return by a corporation upon some other basis than that of actual receipts and disbursements, the Department rules as follows:

Under this provision it will be permissible for corporations which accrue on their books monthly or at other stated periods, amounts sufficient to meet fixed annual or other charges, to deduct from this gross income the amounts so accrued, provided such accruals approximate as nearly as possible the actual liabilities for which the accruals are made, and provided that in cases wherein deductions are made on the accrual basis as hereinbefore indicated, income from fixed and determinable sources accruing to the corporations must be returned, for the purpose of the tax, on the same basis.

In cases wherein, pursuant to the consistent practice of accounting of the corporation, or pursuant to the requirements of some Federal, state, or municipal supervising authority, corporations set up and maintain reserves to meet liabilities, the amount of which and the date of payment or maturity of which, is not definitely determined or determinable at the time the liability is incurred, it will be permissible for the corporations to deduct from their gross income the amounts credited to such reserves each year, provided that the amounts deductible on account of the reserves shall approximate as nearly as can be determined, the actual amounts which experience has demonstrated would be necessary to discharge the liabilities incurred during the year and for the payment of which additions to the reserves were made; and provided if it shall be found that the amount credited to any such reserve is in excess of the reasonable or probable needs of the corporation to meet and discharge the liabilities for which the reserve is credited, the excess of such reserves over and above the reasonable or probable needs for the purpose indicated, shall be at once disallowed as a deduction and restored to income for the purpose of the tax; and provided further, that in no event will sinking funds or other reserves set up to meet additions, betterments or other capital obligations, constitute allowable deductions from gross income.

This ruling contemplates that the income and authorized deductions shall be computed and accounted for on the same basis, and that the same practice shall be consistently followed year after year. Amounts paid in discharge of any liability or obligation for which a reserve has been set up, as hereinbefore outlined, will, when paid, be charged to the reserve created to meet it, in so far as such reserve is sufficient to meet the liability, provided always that the liability is of a character, which constitutes an allowable deduction within the meaning of the law.

If, upon investigation, it shall be found that returns made upon the basis of accruals and reserves, do not reflect the true net income, the corporation so failing in this way to return the true net income, will not thereafter be permitted to make its returns upon any basis other than that of actual receipts and disbursements.

The reserves contemplated by the foregoing ruling, are those reserves only, which are set up to meet some actual liability incurred, the amount necessary to discharge which can not at the time be definitely determined, and do not contemplate reserves to meet losses contingent upon shrinkage in values, losses from bad debts, capital investments, etc., which losses are deductible only when definitely determined as the result of a closed or completed transaction, and are charged off.

The above instructions from the Department refer to corporations but are plainly applicable to individuals in view of the provision of law giving the individual the same rights as a corporation in this respect.

319.—CORPORATIONS DOING BUSINESS IN PHILIPPINES AND PORTO RICO.

The law provides that a corporation shall make its return to the Collector of Internal Revenue of the district in which it has its prin-

cipal place of business. The Act of September 8, 1916, (Regular Income Tax) was made effective in both the Philippines and Porto Rico, but with the proviso that the administration of the law and collection of the tax should be left to the officials of the insular governments and that all revenue should go intact to such governments. The Department's interpretation of these provisions and their relation to each other is

(a) that a corporation, even though incorporated in the United States, should make return and pay tax in the Philippines or Porto Rico, if its business is done wholly in either insular possession;

(b) that a corporation with its principal place of business (that is, where are kept its books of account and other data from which a return must be made) in the United States, but doing business in the islands, should make return and pay in the United States;

(c) that if a corporation has its principal place of business in the United States and a branch in the Philippines or Porto Rico, it should make return and pay tax in the United States and include in its return all the income of its insular branch office.

[Note: The term "United States," as used above does not include either the Philippines or Porto Rico.]

War Income Tax Different.

Such is the application of the Act of September 8, 1916 to the Philippines and Porto Rico and so must returns under that act (for the Regular Income Tax) be made.

But there is a clause in the War Income Tax section of the War Revenue Act of October 3, 1917, which not only states that the War Income Tax is not applicable to the Philippines and Porto Rico but also gives to the Philippine and Porto Rican legislatures power "to amend, alter, modify, or repeal the income tax laws in force" in the islands.

With the statutes as they stand at this writing, a situation has therefore resulted in which certain taxpayers (individual and corporate) resident in the Philippines or Porto Rico, must make return and pay tax to their respective insular governments **for the Regular Income Tax** (Act of September 8, 1916) **but not for the War Income Tax** (Act of October 3, 1917.) This situation may, however, be changed at any time by either insular legislature repealing or altering the provisions of the Act of September 8, 1916 as they apply to the territory within its legislative jurisdiction.

320.—RULING TAXING FOREIGN GOVERNMENTS NULLIFIED.

One of the new provisions added to the Act of September 8, 1916 by the War Revenue Act provides that nothing in the law shall be construed as taxing the income of foreign governments from investments in American securities or from interest on deposits in American banks. This is a nullification of Treasury Decision 2425 of December 28, 1916 in which the Department construed subdivision (g) of Section 9 of the Act of September 8, 1916 as taxing foreign governments on such income and demanded that returns be filed by the representatives of such governments in the United States.

321.—INVESTIGATION OF RETURNS BY GOVERNMENT.

The Commissioner of Internal Revenue has authority to have the affairs of any taxpayer investigated for the purpose of verifying a return of income. He delegates this authority to field officers of Internal Revenue—deputy collectors, inspectors and agents—who generally work under the immediate local supervision of an Internal Revenue Agent, cooperating with the Collector.

One of these officers, appearing to begin an investigation, should be requested to show his authority . This he will always do, and **his evidence of authority will always be either a letter of assignment to the particular investigation or his pocket commission.** The taxpayer should insist upon the production of this evidence. This suggestion is made because Internal Revenue officers, as all other Federal officers, are sometimes impersonated by those without official connection but with an ulterior purpose to serve.

If, as a result of the investigation, additional tax is assessed, **the individual or corporation should always insist upon an explanation of the increase before paying it.** The taxpayer has a right to such explanation and the Collector has the authority and all the necessary data at hand to furnish it. This suggestion is made because frequently a taxpayer receives notice of an increase of tax without an explanation of the basis of the increase.

If, after considering the explanation, the taxpayer feels that the additional assessment is unjust or erroneous, payment of the tax can be deferred and the matter can be submitted to the Department, through the office of the Collector, in a **claim for abatement** of the assessment. (See chapter "Claims for Abatement and Refund of Tax").

Request for Explanation.

Again, instead of the appearance of a field officer, there will come a letter from the Department at Washington, or from the Collector, calling attention to certain items of deduction that have appeared in a return and requesting further information regarding them. Such a letter usually gives a limited time for reply (for example, 30 days), the alternative being a disallowance of the questioned item and an increase of assessment. The taxpayer should comply with the request within the time specified in the letter.

Books Cannot Be Withheld.

Books of account and other records cannot be withheld from an investigating officer. The officer can report to the Collector, who has ample authority to take possession of any books and records and to summon and put under oath any witness essential to the investigation.

322.—INFORMATION CONFIDENTIAL.

Internal Revenue officers cannot divulge any information obtained while acting in their official capacity or any fact disclosed by a return of income, or any other tax return. All information must be kept inviolable.

323.—HOW RETURNS ARE OPEN TO INSPECTION.

All returns must be transmitted to the office of the Commissioner of Internal Revenue in Washington, D. C., for permanent filing.

While the law says that the returns "shall constitute public records and be open to inspection as such," it provides that such "inspection" shall be only upon the order of the President, under rules to be prescribed by the Secretary of the Treasury and approved by the President. The statute itself, however, adds that the proper officers of any State imposing a general income tax may, upon the request of the Governor, have access to the returns, (or to an abstract of them) showing the name and income of each corporation—but also under rules prescribed by the Secretary of the Treasury.

324.—GAIN OR LOSS IN SALE OF PROPERTY BY LEGATEE.

When property is sold or otherwise disposed of for an amount more or less than cost, if acquired on or after March 1, 1913, or more

or less than the fair market value of the property as of March 1, 1913, if acquired prior to that date, the gain must be included in income or the loss can be deducted if otherwise such loss meets the requirements relative to deductible losses.

However, **in the case of property acquired by a legatee,** the Department has ruled that when an individual dies on or after March 1, 1913, leaving property, gain or loss resulting from a subsequent sale by the legatee should be computed on the basis of the appraised value of the property at the time of death.

325.—PERMANENT IMPROVEMENTS MADE UNDER LEASE.

Where, under the terms of a lease, a tenant agrees to erect a building or make certain fixed improvements, the difference between the cost of the building or improvements and a reasonable allowance for the exhaustion, wear and tear of the property while under the lease is gain to be accounted for by the lessor. In such circumstances the tenant can prorate the cost of the building or improvement over the life of the lease and deduct as an expense of business in the return for each year one year's prorata of the cost. In other words, the tenant practically regards such expense as rental. The lessor, however, does not have to account for his gain from the acquisition of the building or improvements until, at the expiration of the lease, the building or improvements come into his possession.

326.—BROKERAGE INTEREST RECEIVED AND PAID.

A decision of interest to a corporation engaged in the brokerage business is that in the case of Altheimer & Rawlings Investment Co. v. Allen Collector (U. S. District Court for the Eastern Division of the Eastern District of Missouri.) According to the facts in that case, the corporation did a brokerage business and bought securities for its customers. The customers paid only part of the purchase price, but paid interest on balances. And the corporation, in buying the securities, paid only a part of the purchase price, leaving balances on which it likewise paid interest.

In making its return of income the brokerage corporation included in **gross income** the difference between interest received and interest paid out. The Court held this method to have been incorrect, stating that the corporation should have included in gross income the amount of interest received from its customers and that it was entitled to a deduction for interest paid out.

327.—TIMBER AND LUMBER COMPANIES— SPECIAL RULES.

The Department has several times changed its rulings with reference to the method to be followed in making return of income from a property consisting of timber and timber lands when the timber is either sold as such or is manufactured into lumber. The latest and controlling ruling, issued in an official letter under date of March 10, 1917, is as follows:

> Corporations owning timber lands and logging off the timber and manufacturing it into lumber, will, if the timber was acquired prior to March 1, 1913, be permitted to exclude from gross income either through a deduction from gross receipts or through a charge into the cost of manufacturing the timber into lumber, an amount equivalent to the fair market price or value of the standing timber as of March 1, 1913.
>
> In order to secure the benefit of this deduction such corporations must set up on their books, as of March 1, 1913, the fair market price en bloc of all the timber then owned by them, and then, by dividing this en bloc value by the estimated number of feet (board measure) in the entire timber holdings, the per unit price or value as of March 1, 1913 will be ascertained, which per unit price or value will be the basis for measuring the amount which may be added to the cost of manufacture, or deducted from gross income, until the en bloc value of the entire holdings, as of March 1, 1913, shall have been extinguished, after which no further deduction on this account shall be allowed.
>
> The same rule will apply in the case of timber or timber lands purchased subsequent to March 1, 1913, the only difference being that actual cost, that is, the gross purchase price, shall, in making the computation, be substituted for en bloc price or value as of that date.
>
> If the entire market price or value of both timber and lands, as of March 1, 1913, or the entire cost, if acquired subsequent to that date, is extinguished through a deduction from gross income for timber used, or through a per unit charge to cost of manufacturing lumber, then the entire amount realized from the logged-off lands or for other salvage will be returned as income of the year in which such lands are sold or disposed of.
>
> If the timber or timber lands are sold en bloc, the gain or loss will be ascertained on the basis of the difference between the fair market price or cost and the selling price, accordingly as the property was acquired prior or subsequent to March 1, 1913.
>
> The fair market price or value of timber or timber lands, as of March 1, 1913, is the price at which the property in its then condition and with the circumstances then surrounding it, could have been sold for cash or its equivalent. This value must not be speculative, but must be determined without taking into account any prospective profits that may result from the manufacture of the timber into lumber. It must be, as the law contemplates, a fair market value, and, once determined, must be set up on the books, and, as the measure of a stumpage deduction for income tax purposes must remain constant and cannot be increased. The value so set up, as of March 1, 1913, will be subject to the approval of the Commissioner of Internal Revenue.
>
> The ruling contained in the above regulation will refer equally as well to the years 1913, 1914 and 1915, with the exception that the cost of the timber shall be the governing basis instead of its value as of March 1, 1913. (Note—The provision relative to fair market price or value as of March 1, 1913 did not appear in the law prior to passage of the Act of September 8, 1916.)

With reference to the regulation just quoted, it is suggested that the taxpayer in making return state what is believed, in such taxpayer's opinion, to be the fair market price or value of the timber as of March 1, 1913, and give reasons for such conclusion. If the figure does not meet with the approval of the Treasury Department, the Department can only take the matter up with the taxpayer for further discussion and, if then not satisfied, reduce the amount and increase assessment accordingly. No penalty can be incurred.

While the ruling refers only to corporations owning and operating timber properties, it is applicable to individuals engaged in and making returns of income from the same kind of business.

328.—RESPONSIBILITY FOR TAX OF DISSOLVED CORPORATION.

When a corporation is dissolved or liquidated during the year, it is required to make a final return. This final return may be made either at the time of dissolution or within the time prescribed for a return for that year—preferably, however, at the time of dissolution. If any tax is shown to be due, the officers of the corporation should retain sufficient funds to pay it. The Government holds them responsible.

329.—ORGANIZATION EXPENSES CANNOT BE DEDUCTED BY CORPORATION.

The organization expenses of a corporation have been held not to be deductible in the corporation's return of income. By such expenses are meant expenditures in the employment of attorneys, accountants, the payment of State fees and the other expenses connected with the incorporation and organization of the company. An expense of this kind is held to be a capital expense, offset by the value of the corporation's franchise, and not "an ordinary and necessary expense of maintenance and operation," the kind allowed to be deducted, in the language of the law.

330.—INCOME PAID IN LIBERTY BONDS.

The question having arisen as to whether a dividend paid in Liberty Loan Bonds was returnable for tax, the Treasury Department submitted the matter to the Attorney General of the United States. As the bond issue in question was the first, the Attorney General based his opinion upon the act authorizing that issue and held as follows:

"The Act of April 24, 1917 provides as to the bonds thereby authorized that

"'the principal and interest thereof . . . . shall be exempt, both as to principal and interest, from all taxation, except estate or inheritance taxes, imposed by authority of the United States, or its possessions, or by any State or local taxing authority.'

"Like every exemption from taxation, this provision must be literally construed and cannot be extended beyond its precise terms. It protects an owner of these bonds from any tax of whatever character, except estate or inheritance taxes, levied upon them by reason of his possession and ownership; but a tax levied upon one's net income or annual gain cannot be evaded because the income or gain happens to be liquidated by the delivery of a certain number of these bonds or other non-taxable securities. **Such a tax is upon the income itself as an entirety and not upon the specific articles into which this income is finally transmuted.** When these bonds, therefore, are used as a medium of payment, whether in the discharge of a private debt or a corporate dividend, the profit or gain to the recipient is nevertheless subject to income tax."

The Attorney General's opinion would be just as applicable to income in the payment of which the bonds (Liberty Loan of Second Series) or certificates authorized by the Act of September 24, 1917 are used as the medium of payment. In other words, while the interest paid on the bonds themselves is taxable as income only as specifically prescribed in the Act of September 24, 1917 with respect to the second series, the exemption does not extend to any other kind of income paid in bonds—where the bonds as a medium of payment become the equivalent of cash.

The Department has therefore held that a payment of income in bonds—for instance, the payment of a dividend by the distribution of such bonds to the stockholders—is taxable to the recipient.

For the sake of clarity the exemptions with respect to the subjection of the interest paid on the bonds to income tax should be stated here again. They are as follows:

Liberty Loan Bonds (First Series)—both principal and interest exempt from all taxes, both Federal and local, except estate and inheritance taxes.

Liberty Loan Bonds (Second Series)—both principal and interest exempt from all taxes, both Federal and local, except (a) estate or inheritance taxes and (b) graduated additional income tax and excess profits tax. However, in the case even of the graduated additional income tax or excess profits tax the recipient of the interest enjoys exemption to an amount not in excess of the interest on bonds of a principal of $5,000.

The entire amount of interest received on bonds of both series is exempt from the normal income tax.

331.—IN DISPUTED TAX CASE ABATEMENT CLAIM STAYS PENALTY.

When a tax has been assessed and demand made for its payment and the person or corporation assessed objects to payment on the ground that the tax is unjust or erroneous, such person or corporation has the right to file with the Collector a claim for the abatement of the assessment. If this claim is filed within ten days after the receipt of demand for payment, the time ceases to run against the claimant as to the 5 per cent penalty provided for delinquency in payment. In other words, if the claim is eventually rejected and another demand made for payment, the 5 per cent penalty does not accrue when payment is made within ten days of such additional demand. However, interest at the rate of one per cent a month accrues from the date the time given in the first ten-days demand expired until date of actual payment. (For instructions relative to filing claim for abatement see chapter on "Claims for Abatement and Refund of Tax.")

332.—DEVELOPMENT CHARGES ON A FARM.

In passing upon field officers' reports of investigations the Department has taken the position that it prefers to consider that all money expended in connection with a farm or ranch prior to the time the property reaches a productive stage represents an investment of capital and should not be a deduction in a return of income.

333.—WHEN ACTUAL OWNER IS NOT OSTENSIBLE OWNER.

Another case has arisen in connection with the practical administration of the law where the following condition was found:

A farming property in the name of Mr. John Doe and actively operated by him was found to have been purchased with his wife's money. John Doe objected to making return of the income, insisting that, although he had been the ostensible owner, the property really belonged to his wife. The field officer declined to accede to his request, but the Department overruled the field officer and directed that both income and deductions in connection with the property be accounted for in the return filed by the wife.

334.—INTEREST AND TAXES ON RESIDENCE DEDUCTIBLE.

While the income tax law does not allow an individual in deducting the expenses of business to include any personal, living or family expenses it does under the allowances for deduction of interest and taxes permit him to deduct interest paid on money borrowed to build a home or to meet personal or family expenses; also it allows him to deduct taxes paid on his residence and personal property. The deductions for interest and taxes are not restricted to expenditures in connection with the individual's business. In cases where field officers have disallowed deductions of interest and tax payments of this kind, they have been overruled by the Department.

335.—LOSS FROM ENDORSEMENT OF NOTE ALLOWABLE.

The loss sustained by an individual by reason of having to pay a note which he has endorsed can be deducted as a bad debt for the year in which paid, provided the endorser is unable to obtain reimbursement from the maker of the note.

336.—PAYMENT BY NOTE REPRESENTS INCOME.

The Department has held that income paid by promissory note must be returned for tax. The question came up particularly in connection with a rental payment of $1500 a month. The tenant was not able to make full payment in cash, but did pay $750 in cash and $750 by note each month. The landlord was required at the end of the year to return the entire amount of the rental, $18,000, as income for tax. The Department held that a promissory note should be regarded as the equivalent of cash. Subsequently, if the landlord should be unable to collect on the notes, he would be allowed a deduction on account of bad debts against the income of the year in which he found the notes to be worthless.

337.—DIVIDENDS RECEIVED BY ONE CORPORATION FROM ANOTHER.

In considering the two income tax laws now in effect—the Act of September 8, 1916 (termed in this book the "Regular Income Tax") and the Act of October 3, 1917 (termed in this book the "War Income

Tax")—the taxpayer **must regard in two ways** the dividends which one corporation receives from another corporation also subject to income tax.

In the computation of the tax imposed by the Act of September 8, 1916 (Regular Income Tax) at the rate of 2 per cent one corporation must include in its gross income the entire amount of dividends received on the stock of another corporation and is not allowed any credit or deduction on such account.

But in the computation of the tax imposed by the Act of October 3, 1917 (War Income Tax) at the additional rate of 4 per cent a corporation is allowed a credit for the amount received as dividends on the stock of another corporation subject to the tax.

The Holding Company.

Under the Act of September 8, 1916 it often happens that the entire gross income of a holding company consists of dividends received on the stock of the operating company. **Both corporations have to make return and pay tax on total net income.** Each corporation is regarded as a distinct and taxable entity. In such a case the net income of the operating company may be practically the gross income of the holding company and the holding company's allowable deductions may be almost inconsiderable; nevertheless, the income from the operation of the property does, before it reaches the individual parties at interest (the stockholders of the holding company) become subject to two assessments of income tax—one against the income of the operating company and the other against the income of the holding company. The Department has insisted upon a full return from every holding or subsidiary corporation maintaining a corporate existence of its own.

338.—VALUE OF STOCK DIVIDEND.

One of the amendments to the Act of September 8, 1916, carried by the War Revenue Act, specifically provides that a stock dividend shall be regarded as income to the stockholders to whom the distribution is made, the same as a cash dividend. Prior to such amendment a stock dividend was returnable at its "cash value" and there was a great deal of controversy over the Department's definition of

"cash value." Now the law states that the stock dividend shall be returned to the amount of the earnings or profits so distributed.

339.—DIVIDENDS OUT OF SURPLUS— FROM ACCUMULATED EARNINGS.

So involved is the language of the statute relative to the imposition of the income tax upon income represented by dividends received by the shareholder in a corporation when the corporation has declared and paid such dividends out of surplus, the subject must be gone into in detail. But the administration of the law in this respect is bound to be complicated and, in a sense, arbitrary, and that numerous controversies will result is certain.

The question is one of the utmost importance to the shareholder in a corporation, in view of the fact that dividends in the hands of an individual are subject to the high percentages of the additional tax under both the old and the new income tax laws.

First, in order that the statute may be read in connection with an interpretation of its meaning, the new section added by one of the amendments carried by the Act of October 3, 1917 is quoted as follows:

Sec. 31. (a) That the term "dividends" as used in this title shall be held to mean any distribution made or ordered to be made by a corporation, joint-stock company, association, or insurance company, out of its earnings or profits accrued since March 1, 1913, and payable to its shareholders, whether in cash or in stock of the corporation, joint-stock company, association, or insurance company, which stock dividend shall be considered income, to the amount of the earnings or profits so distributed.

(b) Any distribution made to the shareholders or members of a corporation, joint-stock company, or association, or insurance company, in the year 1917, or subsequent tax years, shall be deemed to have been made from the most recently accumulated undivided profits or surplus, and shall constitute a part of the annual income of the distributee for the year in which received, and shall be taxed to the distributee at the rates prescribed by law for the years in which such profits or surplus were accumulated by the corporation, joint-stock company, association, or insurance company, but nothing herein shall be construed as taxing any earnings or profits accrued prior to March 1, 1913, but such earnings or profits may be distributed in stock dividends or otherwise, exempt from the tax, after the distribution of earnings and profits accrued since March 1, 1913, has been made. This subdivision shall not apply to any distribution made prior to August 6, 1917, out of earnings or profits accrued prior to March 1, 1913.

Such is the law. It had not been interpreted by the Treasury Department when this book went to press. No doubt it will be given a general official interpretation, but even then, many controversies will arise when administration threatens to work inequity in individual cases, and, as with the interpretation of so many other requirements

of the law, special attention and consideration will have to be given to individual cases.

This tentative and unofficial interpretation is given, subject to correction later to be made by supplement or letter, if necessary, after the Department has stated its understanding of the statute and indicated its procedure.

There are four basic considerations to be kept in mind whenever the taxability of income as represented by a dividend is in question:

(1) That part of an individual's income represented by a dividend from a corporation is not, in any circumstances, subject to the normal tax. It is subject to the additional tax when it forms part of a total net income sufficiently large, as a whole, to be subject to additional tax. (For the year 1917 and subsequent years, in excess of $5,000; for the years 1913, 1914, 1915 and 1916, in excess of $20,000).

(2) The entire amount of income represented by dividends, received by one corporation from stock owned in another corporation, is subject to tax in the hands of the recipient corporation in the computation of tax liability under the Act of September 8, 1916 (the old income tax law) for all years beginning with the year 1913.

(3) The entire amount of income represented by dividends, received by one corporation from stock owned in another corporation, is allowed as a deduction and, therefore, is not subject to tax in the hands of the recipient corporation in the computation of tax liability under the Act of October 3. 1917 (new or War income tax law) for the year 1917 and subsequent years.

(4) Both income tax laws (Act of September 8, 1916 and Act of October 3, 1917) are in effect and the different requirements of the two with respect to income represented by dividends received by one corporation from stock owned in another corporation must be complied with in the computation of a corporation's total income tax liability.

With the above considerations in mind the provisions of Section 31. added to the Act of September 8, 1916 by the War Revenue Act and quoted above, seem capable of being stated as follows:

(1) A dividend, received by either an individual or a corporation, is taxable only when it represents a distribution of earnings or profits accrued to or earned by the distributing corporation since March 1, 1913.

(2) If a dividend is taxable in the hands of the recipient, either an individual or a corporation, the form or medium of payment makes no difference. It can be in either cash or stock, or otherwise, with a stock dividend to be accounted for to the amount of the earnings or profits so distributed by the distributing corporation.

(3) The presumption of the law is that a dividend is paid out of the most recently accumulated undivided profits or surplus; that is, a dividend out of undivided profits or surplus must first be considered as distributing the earnings accumulated in the years since March 1, 1913 before it can be regarded as drawing upon earnings accumulated prior to March 1, 1913. If such dividend is in excess of the additions to surplus since March 1, 1913, the amount by which it exceeds such additions, and only such amount, is to be considered as paid out of earnings accrued to the distributing corporation prior to March 1, 1913 and, therefore, as not taxable to the recipient. If a dividend paid out of undivided profits or surplus does not exceed additions since March 1, 1913, the entire amount of it is taxable to the recipient.

(4) A dividend paid out of undivided profits or surplus—when out of earnings accrued since March 1, 1913—may be out of earnings accumulated in more than one year. But it must be included by the recipient individual or corporation in the return for the year in which received, although to the particular part of such dividend definitely representing a distribution of earnings of a particular year will be applied the tax rate or rates provided by law for that year.

(5) The law contains an exception with respect to any distribution made prior to August 6, 1917, the date when the amended income tax law was reported in the Senate. Under the law and regulations in effect then a corporation could designate its accumulated earnings accrued prior to March 1, 1913 as the earnings distributed and the dividend was exempt from tax to the shareholders. The exception in the present law respects any such designation, and the amount of any dividend with its identity thus "branded" remains exempt from tax, in the case of a distribution prior to August 6, 1917.

In paragraph No. 4 above the statement has been made that it may occur that a dividend included in a return for the year when received may be subject to tax under the rates applicable to one or more other years—the year or years when there accrued the earnings distributed by it. The rates for the year 1917 and subsequent years appear elsewhere in this book. The only rates of tax in effect in other

years to which any such dividend could be subject are as follows:

Rates of 1913, 1914 and 1915.

Individuals.

Only to additional tax as follows:

Income between	$ 20,000	and	$ 50,000	1	per cent
" "	$ 50,000	"	$ 75,000	2	" "
" "	$ 75,000	"	$100,000	3	" "
" "	$100,000	"	$250,000	4	" "
" "	$250,000	"	$500,000	5	" "
" above	$500,000			6	" "

Corporations.

The flat rate of 1 per cent upon the entire amount.

Rates of 1916.

Individuals.

Only to additional tax as follows:

Income between	$ 20,000	and	$ 40,000	1	per cent
" "	$ 40,000	"	$ 60,000	2	" "
" "	$ 60,000	"	$ 80,000	3	" "
" "	$ 80,000	"	$ 100,000	4	" "
" "	$ 100,000	"	$ 150,000	5	" "
" "	$ 150,000	"	$ 200,000	6	" "
" "	$ 200,000	"	$ 250,000	7	" "
" "	$ 250,000	"	$ 300,000	8	" "
" "	$ 300,000	"	$ 500,000	9	" "
" "	$ 500,000	"	$1,000,000	10	" "
" "	$1,000,000	"	$1,500,000	11	" "
" "	$1,500,000	"	$2,000,000	12	" "
" above	$2,000,000			13	" "

Corporations.

The flat rate of 2 per cent upon the entire amount.

To illustrate the above interpretation of the law:

Suppose a corporation, to be known in this example as the California Fruit Company, had on March 1, 1913 a surplus of $1,000,000. In the year 1914 it added $200,000, in the year 1915 $200,000 and in the

year 1916 $100,000. Thus, on January, 1, 1917 the surplus of the company stood at $1,500,000. In the year 1917 subsequent to August 6, the company declares a dividend of $1,000,000, to be paid out of surplus.

Does the dividend out of surplus represent the earnings of the company prior to March 1, 1913, in view of the fact that on March 1, 1913 there was a surplus equal to the amount of the dividend declared and paid in 1917, or must the additions to surplus since March 1, 1913 and prior to the declaration and payment of the dividend be taken into consideration in determining the taxability of the dividend in the hands of the recipient shareholders?

The presumption of the law is that the dividend is paid out of the most recently accumulated surplus. Therefore, the additions to surplus in the years 1914, 1915 and 1916, totaling for those three years $500,000, must be regarded as distributed by the dividend, with the remaining $500,000 of the dividend coming out of surplus from earnings prior to March 1, 1913. And so one-half of the dividend is taxable to the shareholders.

John Smith owns 100 shares of the stock of the California Fruit Company and he receives in the year 1917, when the dividend is paid out of surplus, $300 a share, or $30,000 in all. From other sources he has a net income for the year 1917 amounting to $25,000. How must he treat the dividend of $30,000 in making return to the Government and how is it subject to tax?

Only one-half of the $30,000, or $15,000, need be returned as taxable income because, as shown above, only one-half of the dividend has been paid out of the earnings of the corporation since March 1, 1913.

And the amount of $15,000 is not subject to tax at the 1917 rates. An amount equal to two-fifths of it, or $6,000, belongs to the year 1914 and is taxable according to the rates then in effect; two-fifths, or $6,000, to the year 1915, taxable at that year's rates; and the remaining one-fifth, or $3,000, to the year 1916, taxable at that year's rates.

Smith's liability to tax upon his 1917 income is computed upon the $25,000 net income from other sources and at the 1917 rates. Then $6,000 is added to the $25,000 and tax is computed for the year 1914 upon the $6,000, according to the additional tax rate of 1 per cent applicable to income between $20,000 and $50,000, the tax being $60. Next the same method is followed with respect to the two-fifths of the dividend belonging to the year 1915, and the tax rates for that year being the same as in the year 1914, the amount of tax found to be

due is the same, or $60. And then the amount of $3,000 is added to the $25,000 and tax is computed for the year 1916 upon the $3,000 according to the additional rate of 1 per cent then applicable to income between $20,000 and $40,000, the tax being $30. The total tax upon the $15,000 would be $150.

In the example just given the 1 per cent additional rate happened to be applicable in the computation under each year's schedule. But the reader can see how, were the amount of the dividend larger, the addition of the amount of it apportioned to each of the three years to the net income from other sources (the $25,000) might result in assessment according to different additional rates in different years.

Suppose another stockholder of the California Fruit Company is the California Warehouse Company. This corporation stockholder also receives $30,000 of the dividend paid out of surplus by the California Fruit Company in the year 1917. Of the amount only $15,000 is subject to tax as follows: $6,000 for the year 1914 at the flat rate of 1 per cent—tax $60; and $6,000 for the year 1915 at 1 per cent—tax $60; and $3,000 for the year 1916 at the flat rate of 2 per cent—tax $60; total tax upon the $15,000—$180.

Again, if the dividend of $1,000,000 had been declared and paid by the California Fruit Company prior to August 6, 1917 and if the company had provided by the proper action of its directors that such dividend was to be paid out of surplus earned prior to March 1, 1913, the Government would be obliged to respect the action of the company and no part of the dividend would be subject to tax in the hands of the shareholders. Neither Smith nor the California Warehouse Company would have to account for any part of the $30,000 received by each.

340.—ACCOUNTS RECEIVABLE MAY BE INCLUDED.

While the income tax law imposes a tax upon "income received," it also provides for return upon any other basis than that of actual receipts and disbursements for the year. Three years of experience in administering the law proved that its administration must run along the lines of customary business procedure provided such concession to business procedure does not allow evasion of tax. Consequently accounts receivable in the case of a business with outstanding and uncollected accounts at the end of the year may be treated as though they had been collected. The amounts represented by them may be regarded as having been received in striking the balance on the year's business.

Often, of course, accounts receivable are not received. Any amount represented by an uncollectible account, which has been included as income, can subsequently be charged off as a bad debt in the return for the year in which it is ascertained to be uncollectible; but it must be charged against the income of the year in which the account is found to be worthless. If it should happen that the gross income for that year were not sufficient to cover losses due to accounts previously returned as income and in that year ascertained to be uncollectible, the taxpayer would not appear to have any means of recovering the amount of tax paid upon income represented by such accounts.

341.—INCOME FROM MERCANTILE BUSINESS.

The general rule which in its regulations, decisions and correspondence the Department has provided for ascertaining the income of a mercantile business is as follows:

The inventory of stock, taken at the beginning of the year (or more generally at the close of the preceding year) should be added to the purchases during the year for which the return is made. This total represents what the merchant has put into his business. Then the sales during the year should be added to the inventory taken at the close of the year, the sum standing for what has come out of the business during the year. The difference between the two totals represents the merchant's **gross income** for the year, provided the sum of sales and closing inventory be in excess of the sum of opening inventory and purchases. The amount of **gross income** thus ascertained should be entered as such. This is not the amount, however, which is subject to tax, for the merchant is allowed the usual deductions. On the opposite side of his return he can deduct all the necessary and ordinary expenses of his business such as cost of labor, fuel, rent, etc., and allowances for interest, taxes and losses within the limits imposed by statute.

The opening and closing inventories should be on the same basis, whether at cost or otherwise.

342.—ROYALTIES FROM MINES AND WELLS.

The income that comes from the leasing of a mine or an oil or gas well in the form of a royalty paid by the lessee, according to production, must be returned by the lessor recipient for tax. There have been numerous controversies between the Government and the owners of ore, oil and gas properties on this point, the owners having con-

tended that the process of mining ore or producing oil or gas represents merely a conversion of capital The requirement is, however, that the lessor account for such royalties as a part of gross income and then avail himself of the privilege to claim against his income from royalties deduction for loss on account of the exhaustion of his ore deposits or the reduction in flow from his oil and gas properties.

343.—HOW A CORPORATION CAN GET BENEFIT OF INTEREST DEDUCTION.

As explained in reference to the deductions allowed a corporation, the deduction on account of interest paid during the year is limited to the interest paid upon an indebtedness equal to the sum of the paid up capital stock of the corporation and one-half of its interest-bearing indebtedness outstanding at the close of the year. Thus an arbitrary maximum principal has been fixed by law and the problem is how to take full advantage of it, as every corporation has a right to do.

The limitation as to principal is not to be interpreted as meaning that interest paid during the year cannot be deducted at all unless the indebtedness on which it has been paid remains outstanding at the close of the year. Such interest can be deducted, regardless of when during the year the indebtedness on which it is paid is disposed of, provided the amount of the indebtedness be taken into consideration with respect to the limitation upon principal above noted. It is probably best to illustrate:

The West Realty & Investment Company (so named for this example) has at the close of the year 1917 a paid-up capital stock outstanding of $100,000. Its interest-bearing indebtedness at the close of the year is $300,000. To determine the maximum principal for the purpose of ascertaining its possible interest deduction it would add to the amount of $100,000 (paid-up capital stock) one-half of $300,000 (interest-bearing indebtedness outstanding at the close of the year). The sum would be $250,000, the maximum principal.

The company's indebtedness, above referred to, consists of the following items: a bond issue of $100,000 at 5 per cent; bank loans aggregating $60,000 at 6 per cent; owing under a mortgage upon a building it has constructed $90,000 at 7 per cent; owing upon various notes for short-term loans $50,000 at 8 per cent. Thus its indebtedness stands at the close of the year. However, other short-term notes to the amount of $40,000 having become due on December 1, it has paid them and interest upon them for the last year at 8 per cent.

How can the company arrive at its maximum deduction for interest?

Assuming that the company has paid the interest upon its obligations, it can proceed in the computation as follows:

	Principal Used	Maximum Principal
		$250,000
First take indebtedness on which highest rate of interest is paid, which consists of short-term notes outstanding of $50,000 and those paid Dec. 1 of $40,000, both at 8 per cent	$90,000	
Next take amount on which next highest rate is paid, which is amount due under mortgage on building for $90,000 at 7 per cent	$90,000	
Next take bank loans on which third rate of interest (working scale downward) is paid, which is the $60,000 at 6 per cent	$60,000	
Having now used $240,000 of the maximum principal, only $10,000 of the $100,000 bond issue can be taken, at 5 per cent	$10,000	
Total	$250,000	$250,000

There then remains $90,000 of the bond issue at 5 per cent, upon which interest has been paid but for which payment no deduction can be claimed. It is obviously better, however, that the indebtedness "left over" in excess of the statutory limit be that on which 5 per cent has been paid than it be indebtedness on which one of the higher rates has been paid. The law's limitation has nothing to do with the rate of interest paid: it applies only to the fixing arbitrarily of a maximum principal.

An extreme example has been given, but deliberately so, in order to emphasize the illustration.

344.—CARRYING CHARGES AS PART OF PROPERTY COST.

In ascertaining gain or loss from the sale or disposition of property when cost is the basis of computation it is proper to add to the

original purchase price certain expenses incident to the purchase, holding and sale of the property in order that its actual cost may be determined. In this respect it should be understood, however, that the Government will now allow any item of expense to be added which the owner of the property has covered by a deduction in a previous return of income. In other words, incidental expenses or carrying charges cannot be added to the original purchase price for the purpose of reducing the amount of gain to be returned for taxation or for the purpose of increasing the amount of loss to be deducted, if such incidental expenses and carrying charges were deducted in returns made for the years in which incurred.

345.—PROPERTY EXCHANGED WITHOUT CASH VALUATION.

The exchange of property when there is no cash valuation can be regarded as a mere change of assets that need not be accounted for in a return of income. It is only when the exchange is on a cash basis, where a definite valuation is made of the properties exchanged, that there is a closed transaction and a realization of income or loss. When the exchange is not on such a cash basis and the property received in exchange is later sold, the amount of gain or loss must be determined by going back to the cost of the property given in exchange for it.

346.—SALE OF REAL ESTATE ON INSTALLMENTS.

With respect to accounting for the profit derived from the sale of real estate on the installment plan, the Treasury Department has repeatedly changed its position. The latest ruling is that each payment, when received, should be apportioned between a return of the cost of the property and profit. In other words, the Department takes the position that each installment payment received under the contract represents in part, return of the cost, and in part, profit; and that the profit for a year may be thus ascertained.

Prior to the issuance of the above ruling it was the practice of the Department, where title does not pass until the final installment is paid, to hold that the running installment payments on account of the purchase price are merely cash receipts and do not ordinarily represent income for the year in which received. In other words, the sale was regarded as having been completed when the final installment is

paid and title passes, and then the gain from the transaction can be ascertained and returned as income for the year in which the final installment is paid.

In some cases the dealer has accounted for the gain represented by a transaction of this kind as of the year in which the contract of sale is made and, in the event of the contract becoming void prior to payment of the final installment, has claimed allowance for any loss sustained by default on the part of the vendee and consequent lapse of contract, taking into consideration the recovery of the property.

When an installment payment, monthly, annual or for some other fixed period, represents not only payment on account of the principal of the purchase price, but also interest on deferred payments, the amount of it representing interest should be returned as income for the year in which received.

347.—RETURN CAN BE SWORN TO BEFORE ARMY AND NAVY OFFICERS.

Persons in the Military or Naval service of the United States, wherever they may be stationed, can sign and swear to their returns of income before officers of the Army or Navy who are authorized to administer oaths for the purpose of Military and Naval justice and administration.

348.—NON-RESIDENT ALIEN HAS NO EXEMPTION.

A non-resident alien individual is not entitled to the specific exemption allowed a citizen or resident of the United States. He can not claim the benefit of a credit of either $3,000 or $4,000 in making his return of income from sources in the United States.

349.—LIFE INSURANCE IN FAVOR OF FIRM OR CORPORATION.

One of the income tax amendments carried by the Act of October 3, 1917 is to the effect that premiums paid on life insurance policies covering the lives of officers or employees or members of a corporation or partnership can not be deducted by a corporation in its return of income or by a partnership in computing its net earnings in order that each partner may include his share of such net earnings in his individual return.

CHAPTER XXI

THE INCOME TAX

ASSESSMENT AND PAYMENT OF INCOME TAX

350.—RETURNS CHECKED BY COLLECTOR.

Returns of income of individuals and corporations and withholding agents having been filed within the time prescribed by law (on or before March 1 or within 60 days after the close of a corporation's fiscal year) they are checked by the deputies and clerks in the office of the Collector. In other words, the first audit is in the office of the Collector. The returns which pass this audit are listed on assessment lists and forwarded to the Commissioner of Internal Revenue at Washington, D. C. The returns which do not pass this audit are returned to the taxpayer for correction, and, when so returned, should be accompanied by specific instructions and reasons for the change demanded by the Collector. When again sent to the Collector, the amended or corrected return is listed for assessment and sent to Washington.

351.—SENT TO WASHINGTON.

A Collector retains in his office only a partial card record containing only a few of the facts disclosed by a return of income. **All returns remain permanently in the office of the Commissioner of Internal Revenue at Washington.** It is not possible, therefore, for a Collector to comply with a request for a copy of a return after the return has been forwarded to Washington. **Such request should be made directly to the Commissioner at Washington** and will be complied with only when made by the taxpayer (individual or corporation) or the taxpayer's duly authorized attorney or representative.

352.—ASSESSED BY COMMISSIONER.

The tax is assessed by the Commissioner and the assessment list is returned to the office of the Collector. The Collector then issues to each taxpayer a notice of assessment.

353.—TIME OF NOTIFICATION.

The law requires that each taxpayer receive notice of the amount of tax due **on or before the first day of June** (that is, on or before June 1, 1918 for tax due on income for the year 1917, and so on in subsequent years) or, in the case of a corporation filing return on the basis of a fiscal year, on or before the expiration of 90 days from the date when the return is required to be filed. (As the return in such a case must be filed within 60 days after the close of the fiscal year, it follows that notice of tax due, must be given the corporation not later than 150 days after the close of the fiscal year.)

However, as the filing of returns begins immediately after January 1 and as such returns are sent to Washington for assessment and received back as rapidly as they can be handled, notice of amount of tax due may reach the taxpayer long before June 1 or the expiration of 150 days after the close of a fiscal year. Payment need not be made, however, at the time of such early receipt of notice. The taxpayer has the right to defer payment for as long a time as the law allows him—which time is stated in the notice.

354.—TIME OF PAYMENT.

The law requires that the tax be paid **on or before June 15,** in the case of returns regularly filed for the preceding calendar year.

With respect to the return filed by a corporation upon the basis of its own fiscal year, the law requires that the tax be paid within 105 days after the date on which the return is required to be filed. As a return in such circumstances must be filed not later than 60 days after the close of the fiscal year, it follows that the tax must be paid **not later than 165 days after the close of the fiscal year.**

When additional assessment is made by the Commissioner of Internal Revenue as a result of a subsequent investigation of a return, the Collector issues a peremptory ten-day demand for payment of the tax.

355.—WHEN DELINQUENT.

But the penalty for delinquency in payment does not attach the next day after June 15 or the next day after the end of the 165-day period following the close of a corporation's fiscal year.

To any individual or corporation whose tax has not been paid on June 16, or on the 166th day after the close of a corporation's fiscal year, the Collector issues a peremptory demand for payment within 10 days.

If the tax is not paid within 10 days of the date of this notice, the penalty for delinquency attaches, but not before.

356.—PENALTY FOR DELINQUENCY.

The penalty for delinquency in payment is 5 per cent of the amount of tax assessed and interest at the rate of one per cent a month until payment is made.

357.—CAN ENFORCE COLLECTION.

But the Collector is not obliged to await the pleasure of any taxpayer who may choose to let the 5 per cent be added and the interest charges accumulate. If the tax is not paid within 10 days of the date of his first peremptory notice, he is supposed to issue a second 10-day notice and, when the time given in such second notice has expired, he has the authority to issue a Warrant of Distraint and by such warrant direct a deputy collector to seize and sell sufficient property to satisfy the Government's claim. The Collector is given full power in this respect by the Revised Statutes of the United States. He does not have to go into court to seize and dispose of property.

358.—NOTICE BY MAIL LEGAL.

Assessment notices are mailed by the Collector, and such method of notification has been held to be legal and the notice, when so given, is presumed to have reached the taxpayer. The burden is on the taxpayer to prove the contrary to avoid imposition of the penalty for delinquency, according to the Court in the case of United States v. General Inspection & Loading Company (204 Fed. 657.)

359.—NO PENALTY FOR ESTATES OF INSANE, DECEASED OR INSOLVENT.

The penalty for delinquency in payment does not attach, however, to tax due from the estates of insane, deceased or insolvent persons. If a person has regularly filed a return and after having filed such return but before the required date of tax payment has become insane or insolvent or has died, payment of the tax assessed upon the return filed does not become delinquent as in the case of other taxpayers. The Government collects, if possible, but only the amount of the tax assessed.

360.—TIME EXTENDED FOR ABSENCE.

If an individual is absent in a foreign country and cannot comply with a notice for payment of tax within 10 days of the date of such notice, **he should retain the envelope in which he receives the notice** and forward such envelope with payment to the Collector. When payment is made in this way, **the payment being mailed to the Collector within 10 days of date of receipt of notice by the taxpayer** (as shown by the postmark on the envelope), the Department has held that penalty for delinquency does not attach.

361.—CAN MAKE ADVANCE PAYMENT.

Payment of tax can be made, if desired, at the time of filing return. That is, an individual or a corporation, in forwarding or filing a return, can remit or pay the amount of tax shown by the return as prepared. However, such payment is taken by the Collector only as an "advance payment." It is conditional upon the correct amount of tax being shown by the return as filed. Later the taxpayer may receive a demand for additional payment, or be instructed to file claim for refund of an excess payment.

362.—CAN PAY IN INSTALLMENTS.

One of the provisions of the War Revenue Act of October 3, 1917 directs the Secretary of the Treasury to allow the advance payment of income and excess profits taxes **in installments** or in whole not to exceed the estimated tax due. If audit shows that the tax has been overpaid, a refund is authorized.

If payment is made in installments,

(a) at least one-fourth of the estimated tax (as shown by the return) must be paid within 30 days after the close of the taxable year. (That is, not later than January 30 or not later than 30 days after the close of a fiscal year),

(b) at least a second one-fourth must be paid within two months after the close of the taxable year, (explained above)

(c) at least a third one-fourth within four months after the close of the taxable year (explained above),

(d) and the remainder of the tax due must be paid on or before the time fixed by law for payment, (not later than June 15 or 165 days after the close of a fiscal year.)

Credit can be allowed by the Secretary of the Treasury **in case of advance payments** not to exceed 3 per cent per annum calculated upon the amount paid in advance from the date of payment to the date fixed

by law for payment (June 15 or 165 days after the close of a fiscal year). No such credit can be allowed, however, upon any amount by which an advance payment exceeds the tax found to be due, or upon any payment made later than four and a half months after the close of the taxable year. (Not later than four and a half months after December 31 or after the close of a fiscal year).

363.—FORM OF PAYMENT.

Payment may be made in cash, or by postoffice money order, bank draft, cashier's check or certified check. The remittance must be in such form that it can be deposited by the Collector without expense to the Government—that is, at par.

An uncertified check is accepted by a Collector conditionally. It does not represent payment of a tax until itself paid by the bank on which drawn.

The War Revenue Act of October 3, 1917 authorizes Collectors to accept **also certificates of indebtedness** issued under the Act of April 24, 1917 and any subsequent act. These certificates are to be accepted at par and accrued interest.

364.—RECEIPTS FOR TAXES.

There is just one **official receipt** that a Collector can issue for income tax. It is a receipt on what is known as Form 1.

If, in addition to the official receipt on Form 1, a taxpayer desires for filing or in his system of accounting a receipt on his own form, or an indorsement on his voucher check, the Collector is authorized to comply with his request. The Department has advised, however, that in such circumstances the Collector should note on the unofficial receipt the fact that it is "not an official receipt."

If a withholding agent paying normal tax deducted at the source from income paid a number of individuals, or corporations, desires from the Collector a separate receipt for each individual or corporation listed in his withholding return, the Collector must comply with his request. The law so requires.

CHAPTER XXII

THE INCOME TAX

PENALTIES, OFFER IN COMPROMISE AND PROSECUTION

365.—PENALTIES.

Severe penalties are provided in the Income Tax law for failure, neglect or refusal to comply with its provisions. They differ somewhat as to individuals, corporations and withholding agents.

Individuals.

Failure to make return of income at the proper time—a fine of not less than $20 nor more than $1,000—and increase of tax by 50 per cent.

Making a false return—a fine not exceeding $2,000 or imprisonment not exceeding one year, or both—and an increase of tax by 100 per cent.

Corporations

Failure to make return of income at the proper time—a fine not exceeding $10,000—and an increase of the tax by 50 per cent.

Making a false return—a fine not exceeding $10,000—and an increase of the tax by 100 per cent.

Also an officer of a corporation charged by law with the duty and responsibility of making and verifying the corporation's return, who makes a false return with intent to defeat or evade assessment of tax, is liable to a fine not exceeding $2,000, or to imprisonment not exceeding one year, or both.

Collecting Foreign Items Without License.

Any person, corporation or partnership, undertaking as a matter of business or for profit the collection of foreign interest or dividends

without having obtained a license is liable to a fine not exceeding $5,000, or imprisonment not exceeding one year, or both.

For Not Deducting Tax at Source.

Any person, corporation, or partnership failing to deduct at the source the normal tax as required by law is liable to a fine of not less than $20 nor more than $1,000.

Not Filing Withholding Return in Time.

Any person, corporation, or partnership not filing return of tax deducted at the source in time prescribed by law is liable to a fine of not less than $20 nor more than $1,000—and to an increase of the tax by 50 per cent.

Not Giving Information at Source.

Any person, corporation or partnership refusing or neglecting to supply information regarding payments to others, in the form and time prescribed is liable to a fine of not less than $20 nor more than $1,000. This includes **brokers** with respect to the reports required of them concerning their customers and corporations with respect to the reports required of them concerning payments of dividends.

Specific Penalties.

A penalty in the form of a fine is known to the Treasury Department as a **"specific penalty,"** to distinguish it from a penalty in the form of an increase of the amount of tax.

When Penalty Is Not Asserted.

When a return of income is filed **voluntarily and without notice from the Collector,** the law provides that the penalty for delinquency in filing shall not be asserted, **provided the taxpayer can show that failure to file in time was due to a reasonable cause and not to willful neglect.**

366.—OFFER IN COMPROMISE.

Section 3229 of the Revised Statutes of the United States gives the Commissioner of Internal Revenue, with the advice and consent of the Secretary of the Treasury, authority to compromise any civil

or criminal case arising under the internal revenue laws without commencing suit.

An offer in compromise may, therefore, be tendered for any offense under the Income Tax law, as well as under any other internal revenue law.

Following is the procedure:

The taxpayer who has offended should first ascertain from the office of the Collector of Internal Revenue the minimum amount to which the Commissioner will give favorable consideration. No exact schedule of amounts can be given here, although below will be found suggestions based upon experience in handling such offers.

Having fixed upon the amount to tender, the taxpayer will address a letter **(in duplicate)** to the **Commissioner of Internal Revenue** at Washington, D. C. (not to the local Collector.) In this letter the taxpayer will refer to the offense with which he is charged and state that he tenders the amount mentioned in the letter **"as an offer in compromise in lieu of all proceedings, both civil and criminal."** It is important and essential that the emphasized language just quoted be used. It is also necessary that at least one copy of the letter, be not only signed, but **also sworn to by the taxpayer.**

The letter (in duplicate) must then be delivered or mailed to the local Collector **with the amount tendered.** (Note the statement that while the letter is addressed to the Commissioner it must be delivered to the local Collector.)

The Collector will issue a receipt for the amount tendered and will forward the offer to the Commissioner at Washington for his action. The Commissioner will thereafter notify the taxpayer of his acceptance or rejection of the offer. If he accepts the offer, the case is closed; if he rejects it, the taxpayer may tender **an additional offer,** following the same course as with the original offer.

Suggestions.

It is known that the following offers in compromise have been accepted:

$5 from individuals and withholding agents for delinquency in filing returns of income.

$10 from corporations for delinquency in filing returns of income.

$25 for refilling a bottle which has contained bottled-in-bond spirits.

$10 for refilling a cigar box.

$10 for failure to stamp wines when the case was not aggravated.

The above suggestions are not controlling but can be followed quite closely, when no intent to evade the tax can be shown.

367.—PROSECUTION OF OFFENDERS.

In all cases of violation of internal revenue laws it is the first duty of the Collector to notify the offender of his right under Section 3229 of the Revised Statutes to tender an offer in compromise. If an offer is not then made, it becomes the duty of the Collector to report the case for prosecution to the United States Attorney.

CHAPTER XXIII

CLAIMS

FOR ABATEMENT AND REFUND OF TAXES

368.—CLAIM FOR REFUND.

Claim for refund of any tax or penalty erroneously paid or collected can be filed with the Collector under the provisions of Section 3220 of the Revised Statutes of the United States. Section 22 of the Income Tax law of September 8, 1916, as amended by the Act of October 3, 1917, specifically provides for application of the general law to the income tax.

Claim for refund must be filed on what is known as **Form 46.** This official form can be obtained from the Collector. The taxpayer making the claim should fill out only the first page of the claim, stating therein the facts regarding assessment and payment of tax and the reasons why the amount paid should be refunded.

The claim must be sworn to by the individual filing it, or by a member of a partnership or officer of a corporation. If filed in behalf of a partnership or corporation, the relation of the individual who swears to it to such partnership or corporation must be plainly stated. The return can be sworn to before any officer qualified to administer an oath or **before the Collector or a deputy collector.**

To the claim should be attached any evidence that can be offered in support of it. **The Department requires that the receipt for payment of the tax covered by the claim be attached.**

After the claim has been filed with him, the Collector, using blank on the second page, certifies it to the Commissioner at Washington for consideration. The Commissioner subsequently gives notice of

his allowance or rejection of the claim. If he allows it, a Treasury Warrant for the amount refunded is sent directly to the claimant from Washington.

369.—MUST PRECEDE SUIT TO RECOVER.

Section 3226 of the Revised Statutes of the United States provides that no suit for recovery of taxes can be maintained unless the taxpayer has first appealed to the Commissioner of Internal Revenue for relief. Such appeal takes the form of a claim for refund. The filing of a claim is, therefore, an act essentially precedent to the maintenance of a suit to recover taxes erroneously paid to the Government.

370.—TWO-YEAR LIMITATION.

Section 3228 of the Revised Statutes provides that a claim for refund must be filed within two years after the erroneous collection of the tax, if the legal rights of the taxpayer with respect to subsequent suit for recovery of the tax (should the claim be rejected) are to be safeguarded.

The date of filing a claim with a Collector for certification and transmission to the Commissioner is, therefore, very important. This is the date that shows whether the claimant is within or without the two-year limitation. The taxpayer is, for this reason, advised to request of a Collector, or deputy collector, a written acknowledgment of the filing of a claim which will show the date of filing. Thus the rights of the taxpayer will be protected should the claim be delayed or lost in transmission.

371.—EXCEPTIONS TO TIME LIMIT.

While a claim for refund of a tax must, as a rule, be filed within two years after the collection of the tax, pursuant to the provisions of Section 3228, Revised Statutes of the United States, this limitation is removed by the last part of subdivision (a) of Section 14 of the Act of September 8, 1916, with respect to claims for refund of corporation excise tax paid under the Act of August 5, 1909 and income tax paid under the Act of October 3, 1913 and the Act of September 8, 1916, if, **upon examination of a return it is disclosed that tax was paid in excess of the amount due.**

Under this provision claims once rejected because the limitation as to time had expired when they were filed can be reopened, if the question at issue involves the examination of a return.

372.—CLAIM TO COLLECT JUDGMENT.

A claim for money recovered by suit must likewise be filed on Form 46. The successful litigant should so prepare the claim that it will state the names of all parties to the action, the cause of action, date of commencement, date of judgment, court in which recovered and amount recovered. To the claim must be attached a certified copy of the record and judgment of the court and a receipt for all costs from the clerk of the court showing that they have been paid in full. This claim should be filed with the Collector against whom judgment has been obtained. It must be sent by him to Washington for payment.

373.—CLAIM FOR ABATEMENT.

A claim for abatement of a tax or penalty erroneously assessed can be filed, but **prior to payment.** Such claim is to be prepared on what is known as **Form 47,** to be obtained from the Collector by request.

This claim for abatement is intended, of course, so to present a contention of error to the Department that a tax or penalty which has been assessed will not be collected. In it a taxpayer presents his side of a controversy over a disputed assessment. It should be prepared practically as a claim for refund. (See instructions above.)

374.—IN PREPARING FORM 47.

There is a footnote on Form 47 which would confuse any taxpayer without explanation. The footnote requires that "the substance of Circular No. 219 should be embraced in every affidavit on this Form, when applicable."

For the convenience of the taxpayer Circular No. 219 is herewith quoted:

CIRCULAR NO. 219.
Treasury Department,
Office of Commissioner of Internal Revenue,
Washington, D. C., Sept. 1, 1879.

Hereafter, every claim for the abatement or refunding of taxes should contain, at its close, a statement, under oath, in the following form:

"The above statements, together with those heretofore made in writing and filed as evidence by the claimant, embrace all the facts known to the claimant on which this claim is founded."

Collectors and Deputy Collectors, assisting in the preparation of new claims or in the completion of claims returned for additional evidence, will take care that the above statement is supplied or its omission explained.

H. C. ROGERS,
Acting Commissioner.

Approved:
JOHN SHERMAN,
Secretary of the Treasury.

The provisions of the above circular are not always applicable. The circular has been quoted merely that taxpayers may not be mystified as to the meaning of the footnote on Form 47.

375.—CLAIMS FOR ALL TAXES.

Claims for refund and abatement can be filed with respect to all Federal internal taxes assessed, and claims for refund can be filed for taxes the payment of which is denoted by the use of stamps. In the latter case, however, the stamps representing the payment desired refunded should be attached to the claim if they have not been used, or, if they have been affixed to taxable articles or containers of taxable articles, they should be removed in the presence of an internal revenue officer and attached to the claim.

CHAPTER XXIV

THE INCOME TAX

EXTRA INCOME TAX IMPOSED BY ACT OF OCTOBER 3, 1917

One of the heaviest and most far-reaching of the taxes imposed by the War Revenue Act of October 3, 1917 is the War Income Tax—a tax which does not take the place of the Regular Income Tax still in effect under the Act of September 8, 1916, but is to be assessed and collected in addition to that tax.

This War Income Tax affects both individuals and corporations.

It is applicable to income for the **entire year 1917.**

With only a few exceptions the method of computation is the same as that for the Regular Income Tax under the Act of September 8, 1916. The exceptions will be emphasized; but, in general, the individual or corporation should turn to and can rely on the instructions given in detail with reference to the Regular Income Tax.

The Treasury Department will call for **only one return** to cover both the Regular and the War Income Taxes, in the case of either an individual or a corporation.

376.—THOSE WHO HAVE NOT FILED UNDER OLD LAW.

Those individuals whose incomes were not sufficient to make them **liable to file returns** under the provisions of the old law, Act of September 8, 1916, should first determine the question of their **liability to file** under the provisions of the new law, Act of October 3, 1917, as explained in this chapter. They should then turn to instructions given in other chapters for information as to the preparation

and filing of a return and for definitions of income required to be included and deductions allowed. The requirements of the Government with respect to returnable income and allowable deductions under the old law apply to income and deductions under the new law.

Reference has just been made to **"liability to file return."** This is not the same as "liability to tax," and the distinction should be noted. For instance, a single person with a net income of exactly $1,000 is liable to file return but is not liable to tax since after he has filed return and therein claimed the benefit of the specific exemption of $1,000 allowed him, there remains no excess on which to assess tax.

377.—THOSE WHO HAVE FILED UNDER OLD LAW.

Those individuals who have filed returns under the old law will have to ascertain their liability to tax under both old and new laws. They will be subject to all the normal tax heretofore imposed by the old law and, in addition, will be subject to the new normal tax on the amount of net income in excess of the lowered exemption. In case of sufficient income they will also be subject to the new additional, or super-tax, imposed by the new law of October 3, 1917 on net income in excess of $5,000 and, if their net income is in excess of $20,000, will be subject to both the old and the new additional taxes, each computed according to its own scale of graduation.

However, the above point is explained and illustrated in detail in instructions relative to "Combined Computation of Income Tax under Both Laws."

378.—INDIVIDUAL EXEMPTION LOWERED.

The most far-reaching extension of the taxation of income, carried by the War Income Tax part of the War Revenue Act, is to be found in the lowering of the specific exemption to—

$1,000 in the case of a single person, who is not the head of a family, and

$2,000 in the case of a married person living with wife or husband, or in the case of a single person who is the head of a family, with an allowance of $200 for each dependent child.

This means, of course, that many individuals who are not liable under the Act of September 8, 1916 must pay tax under the Act of October 3, 1917.

It also means that those who are liable under the Act of September 8, 1916 are also liable under the Act of October 3, 1917 with their

liability increased by the lowering of the specific exemption and by the application of the tax imposed by the new law to all the income also taxable under the old law.

379.—AMOUNT MAKING RETURN NECESSARY.

Under the provisions of the War Income Tax law every single person with a net income of $1,000 or over, and every married person with a net income of $2,000 or over is required to file a return of income.

The amount of $1,000 in the case of a single person and $2,000 in the case of a married person fixes liability to file return, just as the amount of $3,000 fixed such liability to file return on the part of both single and married persons under the Act of September 8, 1916.

The question of liability to file a return (to make a report to the Government) must therefore be determined solely by the provisions of the new law, the War Income Tax part of the Act of October 3, 1917. This follows from the fact that every individual citizen or resident of the United States who is liable to file a return, according to the requirements of the old law, is also liable to file under the provisions of the new law; and many who were not liable to file returns under the old law are liable to file under the new law.

Liability to file a return, then, must be determined by the amounts specified in the new law—$1,000 for a single person and $2,000 for a married person, such amounts representing net income, not gross income.

380.—NEW NORMAL TAX ON INDIVIDUALS.

The new normal tax, imposed by the War Income Tax part of the Act of October 3, 1917, is at the rate of 2 per cent upon taxable net income of individuals, ascertained exactly as in the computation for the old normal tax under the Act of September 8, 1916, except that the lowered exemption of the new law takes the place of the exemption of the old law. In other words, the new normal tax is assessed upon all taxable net income in excess of $1,000 or $2,000 (plus $200 for each dependent child), while the old normal tax is assessed only upon taxable net income in excess of $3,000 or $4,000, the exemption varying according to the single or married or "head-of-a-family" status of the individual making the return.

381.—NEW ADDITIONAL TAX ON INDIVIDUALS.

The new additional tax, imposed by the War Income Tax part of

the Act of October 3, 1917, is assessed upon all net income in excess of $5.000 according to the following graduated scale:

1 per cent upon the amount by which total net income exceeds $5,000 and does not exceed $7,500.

2 per cent upon the amount by which total net income exceeds $7,500 and does not exceed $10,000.

3 per cent upon the amount by which total net income exceeds $10,000 and does not exceed $12,500.

4 per cent upon the amount by which total net income exceeds $12,500 and does not exceed $15,000.

5 per cent upon the amount by which total net income exceeds $15,000 and does not exceed $20,000.

7 per cent upon the amount by which total net income exceeds $20,000 and does not exceed $40,000.

10 per cent upon the amount by which total net income exceeds $40,000 and does not exceed $60,000.

14 per cent upon the amount by which total net income exceeds $60,000 and does not exceed $80,000.

18 per cent upon the amount by which total net income exceeds $80,000 and does not exceed $100,000.

22 per cent upon the amount by which total net income exceeds $100,000 and does not exceed $150,000.

25 per cent upon the amount by which total net income exceeds $150,000 and does not exceed $200,000.

30 per cent upon the amount by which total net income exceeds $200,000 and does not exceed $250,000.

34 per cent upon the amount by which total net income exceeds $250,000 and does not exceed $300,000.

37 per cent upon the amount by which total net income exceeds $300,000 and does not exceed $500,000.

40 per cent upon the amount by which total net income exceeds $500,000 and does not exceed $750,000.

45 per cent upon the amount by which total net income exceeds $750,000 and does not exceed $1,000,000.

50 per cent upon the amount by which total net income exceeds $1,000,000.

The application of this new additional tax scale (either alone as in the case of a net income exceeding $5,000 but not exceeding $20,000, or in combination with the old additional tax as in the case of a net income exceeding $20,000) is explained and illustrated in instructions relative to "Combined Computation of Income Tax under Both Laws."

382.—NON-RESIDENT ALIENS AND NEW TAX RATES.

The application of the new tax (Act of October 3, 1917) is restricted to the income of citizens and residents of the United States. All citizens of the United States, whether residing at home or abroad, and all aliens residing in the United States are subject to it, but aliens who are not residents of the United States do not have to pay the new tax upon their income from sources within the United States. They do, however, remain liable to the old tax imposed by the Act of September 8, 1916.

383.—NEW TAX ON CORPORATIONS.

The new tax, imposed by the War Income Tax part of the Act of October 3, 1917, upon the income of corporations is at the rate of 4 per cent upon total net income ascertained exactly as under the Act of September 8, 1916, **with the notable exception that in the computation of the War Income Tax a corporation is allowed a credit of the amount received as dividends upon the stock of another taxable corporation.** This credit is not allowed in the computation under the Act of September 8, 1916.

384.—IN CASE OF FISCAL-YEAR RETURN.

If a corporation has fixed its own fiscal year and makes return according to that period, the 4 per cent rate of the War Income Tax is applicable to net income shown in a return for a fiscal year ending in the calendar year 1917 only upon that proportion of such income which the period between January 1, 1917 and the end of its fiscal year bears to the whole of such fiscal year. For example: A corporation has established the right to file return for a fiscal year ending with the last day of August. In such a case only eight-twelfths of the net income shown by its return (and with the credit for dividends from other corporations considered) would be subject to the new 4 per cent rate. Thereafter, however, there would be no such apportionment as the return for each succeeding fiscal year would be for a period wholly within the time beginning January 1, 1917, the effective date of the new rate.

385.—DEDUCTION OF TAX AT SOURCE.

The provisions of the Act of September 8, 1916, as amended, with respect to deduction at the source of the normal tax when the income is in the form of interest paid on bonds containing the so-called "tax-free" guaranty, are made applicable to the normal tax upon income

in the same form due under the new law. This clause is so restricted in its application, however, that it is not effective at all until January 1, 1918, and even from that date no deduction at the source is allowed, under the operation of both income tax laws, of more than one 2 per cent normal tax. If, after that date, the recipient of the income is subject to both 2 per cent normal taxes (under the old and the new law), only one of such taxes can be deducted at the source and the Government will look to the individual recipient of the income for the collection of any remaining normal tax due.

386.—NOT APPLICABLE TO PORTO RICO AND PHILIPPINES.

The provisions of the War Income Tax law are not applicable to Porto Rico and the Philippine Islands. The provisions of the Act of September 8, 1916 (the old or regular income tax law) have been applicable; but the War Income Tax law not only exempts Porto Rico and the Philippine Islands from its own provisions but also empowers the Insular legislatures to amend or repeal the income tax provisions of the old law as such provisions affect the island possessions.

CHAPTER XXV.

ILLUSTRATIVE CASES

INCOME TAX

In addition to the illustrations given throughout the book several illustrative cases of the application of the Income Tax, under both the old and the new laws, are worked out in the examples that follow.

It is suggested that these be followed carefully and that every reference to a paragraph be noted. The references to paragraphs will lead to instructions based upon decisions of the Treasury Department and actual administration of the Income Tax law.

While only a few illustrative cases have been given, many important points are covered by them.

Do not be misled by the heading over each case (for instance, "A BANKER-INVESTOR," "A PHYSICIAN," "A MERCHANT," etc.) into a conclusion that the illustration applies only to the income of a person engaged in the same business, or trade, or practicing the same profession. There are points touched upon, and principles applied, in each case that affect every person.

A BANKER-INVESTOR

John Burnside is president of the Second National Bank of San Francisco, Cal. He is a widower but supports his aged mother and two daughters, of 11 and 21 years of age, respectively. He maintains a country place at Burlingame, but the greater part of the year resides in city apartments which he keeps under lease at an annual rental of $6,000.

Early in the year 1917 Burnside traded in his old automobile and obtained a new one, paying in cash in the transaction the amount of $3,000. He had a chauffeur employed during the entire year, at a wage of $85 a month, to keep the car always at the personal disposal of himself and family.

He also had to keep two caretakers on his country place at a cost of $80 a month in wages and allowed them to purchase their food supplies at Burlingame stores, the bills for such supplies having been presented to him each month for payment, the total payments for the year being $650. He also had to make repairs on his country home during the year at a cost of $1,200.

Burnside's town household servants cost him $900 during the year 1917. At the end of the year he also found that clothing for himself and family had cost $5,000 during the year. Having desired to aid in war work, he gave $1,500 to the Red Cross in March. He also had to make the annual payment of $240 on a college scholarship which he endowed years ago. Dancing and music lessons for his daughters cost $600.

Burnside also found in going over his accounts that dues and other expenses in his clubs amounted to $720.

Late in 1916 he borrowed, on securities as collateral, $20,000 and with the money invested in bonds of Valley Irrigation District No. 2, thereby helping to promote a project for the watering of a territory in which he owns land. He pays the bank 6 per cent for the money and in 1917 made one such annual payment. He has also received 6 per cent interest on the bonds.

He has other indebtedness to banks on which during 1917 he paid interest amounting to $2,800. This indebtedness was incurred for investment in country lands.

He paid local taxes in 1917 to the amount of $2,342, and a Federal income tax in June, 1917, of $968, assessed upon his net income for the year 1916.

Aside from his duties at the bank, Burnside found time to make investments in the stock and bond market. On some magnesite stock which he bought early in the year and sold in December he made a profit of $15,000; some Mexican silver stock he sold during the year for $22,000 less than he had paid for it two years before; some electric railway bonds, which he still held at the end of 1917, he found to be worth, according to the market, only $16,000, whereas he had paid $28,000 for them three years before.

His annual salary at the bank is $24,000. His dividends from corporation stocks during 1917 amounted to $41,000. He also, in November, 1917, sold some of his country lands at a profit of $110,000. Also from the estate of a deceased friend there came to him by inheritance during the year $90,000 in cash.

What income tax does Burnside owe for the year 1917, and how would he make the computation?

ANSWER.

[Comment: In order not to confuse the Excess Profits Tax computation with this sample Income Tax computation, it is assumed, merely for the purpose of the example, that Burnside's Excess Profits Tax, assessed for the year 1917, is $5,000. In an actual case, the actual amount of such tax would appear as the $5,000 does below.]

Burnside's returnable gross income consists of:

Salary from bank	$ 24,000
Profit on sale of lands	110,000
Profit on magnesite stock	15,000
Dividends	41,000
Total gross income	$190,000

His allowable deductions are:

Interest paid on money borrowed for investment in lands	$ 2,800
Local taxes paid	2,342
Of $22,000 loss on Mexican silver stock, only (See Note 1, below)	15,000

Gift to Red Cross. (See Note 2, below)	1,500
Payment on scholarship. (See Note 2, below)	240
Total deductions	$ 21,882

His net income is:
$190,000 minus $21,882, or $168,118

His net income on which income tax can be assessed is:
$168,118 minus $5,000 excess profits tax assessed for same year, (Note 3, below) $163,118

His net income subject to normal tax is:
$163,118 minus $41,000 received as dividends (Note 4, below) $122,118

His exemption is:
$2,200 under new law and $4,200 under old law (Note 5, below)

His normal tax is: (Note 6, below)

2 per cent of $2,000	$ 40.	
4 per cent of $117,918	4716.72	
Total normal tax		$ 4,756.72

His net income subject to additional tax is:
$163,118, with no deduction of dividends (Note 4, below)

His additional tax is:

On $2,500 between $5,000 and $7,500 at 1 per cent	25.	
On $2,500 between $7,500 and $10,000 at 2 per cent	50.	
On $2,500 between $10,000 and $12,500 at 3 per cent	75.	
On $2,500 between $12,500 and $15,000 at 4 per cent	100.	
On $5,000 between $15,000 and $20,000 at 5 per cent	250.	
On $20,000 between $20,000 and $40,000 at 8 per cent	1,600.	
On $20,000 between $40,000 and $60,000 at 12 per cent	2,400.	
On $20,000 between $60,000 and $80,000 at 17 per cent	3,400.	
On $20,000 between $80,000 and $100,000 at 22 per cent	4,400.	
On $50,000 between $100,000 and $150,000 at 27 per cent	13,500.	
On $13,118 over $150,000 at 31 per cent	4,066.58	
Total additional tax		$29,866.58

His total tax is:

Normal tax	$ 4,756.72	
Additional tax	29,866.58	
Total income tax		$34,623.30

Notes

1.—Allowable under Department interpretation of the law to an amount not in excess of profit same year from similar transaction.

[SEE PAR. 90-92-93-94]

2.—Sum of these two gifts does not exceed 15 per cent of taxable net income as it would be without the allowance of deduction of these gifts. There-

fore, the gifts, considering their character, are deductible in full.

[SEE PAR. 101]

3.—Amount of excess profits tax assessed for the same year allowed as credit against net income for assessment of income tax.

[SEE PAR. 103.]

4.—Individual allowed credit for dividends from taxable corporation in assessment of normal tax but not for additional tax.

[SEE PAR. 104.]

5.—He is the head of a family; also he has one dependent child under 18 years of age.

[SEE PAR. 4 (SUB. PAR. 4) ALSO PAR. 105-106.]

6.—New law rate applies on amount over new law exemption and not in excess of old law exemption. Combined rates apply to all over old law exemption.

[SEE PAR. 3 AND PAR. 4 (SUB. PAR. 5.)]

7.—The following expenditures by Burnside are personal, living or family, and, therefore, not deductible: $6,000 rent for city apartments; $3,000 paid for automobile for personal and family use, and $85 a month for chauffeur; $1,200 spent in repairing country home; $80 a month paid caretakers; $650 paid for caretakers' supplies; $900 paid for household servants; $5,000 for clothing for family and himself; $600 for dancing and art lessons of daughters; $720 for club expenses.

[SEE PAR. 69.]

8.—Interest on the $20,000 borrowed to buy Irrigation District bonds is not deductible.

[SEE PAR. 80-65-66.]

9.—Interest received on Irrigation District bonds is exempt from tax, therefore, 6 per cent received on $20,000 in bonds need not be included in return.

[SEE PAR. 62-65-66.]

10.—He has not disposed of his electric railway bonds; therefore cannot deduct the amount by which they have depreciated.

[SEE PAR. 90-311.]

11.—The $90,000 received by inheritance is exempt from income tax.

[SEE PAR. 64.]

A FARMER

Henry Smith owns and farms 640 acres of land. He lives with his family on the farm, his family consisting of a wife, a son of 19 years and two daughters, one 9 and the other 16 years of age. The elder daughter he has had in boarding school at a cost during the year of $600.

Two years ago Smith set 80 acres of his land to peach trees. Another lot of 80 acres is in vineyard which has been in full bearing for two years. A third lot, 160 acres, is in alfalfa. On a fourth lot, 160 acres, he produced a crop of beans but was still holding the beans at the end of the year for a better price. He had, however, early in 1917 sold a crop of beans held over from the harvest of 1916. The remaining 160 acres of his land Smith planted during the year 1917 to two crops—barley which he harvested for hay in the early summer and corn which he harvested in the late fall. He fed a part of the hay to his stock and sold part of it. He used all the corn to fatten his hogs.

Smith's farm was under a mortgage for $20,000 to a bank at the beginning of the year 1917 and on the loan Smith paid a year's interest at 6 per cent during the year. However, he was able also to pay $5,000 on the principal of the loan during the year, so that the encumbrance on his place at the end of the year was only $15,000.

His local taxes during 1917 amounted to $822 and on June 10, 1917 he paid a Federal income tax of $190 which had been assessed upon his income for the year 1916.

Early in 1917 Smith bought some livestock from a neighbor farmer. In the lot were four mules, a bull and 20 head of steers and calves. He contemplated using the mules for farm work, keeping the bull for breeding purposes, and fattening and selling the steers and calves. For the stock Smith paid his neighbor as follows: $500 for the bull, $400 for the mules and $500 for the steers and calves. Early in December he sold the steers and calves for beef and still had and was working the mules. A month before that, however, the bull had become entangled in a barbed wire fence and become so badly cut that it died a few days later.

Toward the end of the year Smith found that he had sold too much of his barley hay and had to buy $400 worth for his stock. During 1917 he also bought the following farm equipment: a motor tractor for which he paid $2,000, a feed-cutting machine for $150, and shovels, axes, pruning shears and plows costing $275.

Smith also had to build an addition to his barn at a cost of $550, and to repair the roof of the old part of the barn at an expense of $90. He also had to pay an irrigation district assessment amounting to $320.

He kept 10 men throughout the year, paying them $45 a month and found. The men ate in quarters specially provided for them and a cook was employed for them throughout the year, her wages being $40 a month. At various times during the harvest extra help to take care of crops had to be employed at a total cost for the year for such extra help of $1,700. Smith also paid out for barley and corn seed during the year $800, and for a fertilizer to use in his vineyard, $500.

Smith paid $1,000 for clothing for himself and family during the year. The family's food bills amounted to $1,600, and those for his employees to $1,850. He also had to spend $200 repairing the basement of the family residence on the farm.

Smith sold during the year 120 tons of raisins at $110 a ton; 650 head of hogs of a gross weight of 146,250 pounds at 16 cents a pound live weight; cattle, including those bought from his neighbor, for $8,200; and barley hay to the amount of $2,750. For his 1916 bean crop he received $15,620. A friend, who had borrowed $2,000 from him two years before, repaid him, both the principal and 8 per cent interest for two years.

How would Smith make up his income tax return for 1917?

ANSWER.

Smith's items of returnable gross income would be:

Proceeds from sale of 120 tons of raisins at $110 a ton;
Proceeds from sale of hogs at 16 cents live weight;
The $8,200 from sale of cattle;
The $2,750 from sale of hay;
The $15,620 from sale of 1916 bean crop in 1917 (Note 1, below)
The two years interest at 8% received by him when his friend paid the note of $2,000. (Note 6, below)

His allowable deductions would be:

As Business Expenses:

The $500 paid his neighbor for steers and calves (Note 2, below)
The $400 paid for hay to feed stock. (Note 3, below)
The $275 paid for shovels, axes, pruning shears and plows. (Note 4, below)
The $90 spent repairing roof of old barn. (Note 5, below)
The wages paid his 10 regular men.
The $1,700 paid for extra help.

The $1,850 paid for food for men.
The wages of employees' cook.
The $800 paid for barley and corn seed.
The $500 paid for fertilizer.

Other Deductions:

The interest paid at 6 per cent on the $20,000 loan secured by mortgage on his farm.
Local taxes of $822.
Loss to amount of $500, cost of bull killed. (Note 7, below)
Depreciation on full-bearing vineyard. (Note 8, below)
Depreciation on farm buildings, except house occupied by Smith and family.
Depreciation on four mules bought from neighbor. (Note 9, below)
Depreciation on tractor and feed-cutting machine. (Note 10, below)

Smith's net income would be ascertained by subtracting the total of his deductions from the total of his gross income. He would then be allowed a credit against such net income of the amount of Excess Profits tax, if any, assessed for the year 1917. This would be done before assessment of income tax.

[SEE PAR. 1—Par. 4 (SUB. PAR. 1 AND 2) AND PAR. 103.]

Smith's exemption is $2,400 under the new law and $4,400 under the old law. (Note 11, below.)

With the exception that he received no dividends, his tax would then be figured as in example of "A BANKER-INVESTOR."

[SEE PAR. 4, (complete.)]

The following expenditures by Smith during 1917 were personal, living or family expenses and not deductible in his return: $600 for daughter in boarding school; $1,000 for clothing for himself and family; $1,600 for food supplies for family; $200 repairing basement of house occupied by family on farm.

[SEE PAR. 69.]

Smith's payment of $5,000 on the principal of the loan secured by a mortgage on his farm is not deductible. The amount of interest paid on the loan is deductible but not any payment on principal. The payment of the $5,000 was entirely a capital transaction and not an expense. It was merely a return by Smith of money previously obtained by him and not accounted for as income when so obtained.

[SEE PAR. 80.]

The $500 Smith paid his neighbor for the bull and the $400 for mules cannot be deducted. Both amounts represent capital investment, since the bull was for breeding purposes and the mules were for work on the farm. These animals, therefore, were a part of the operating equipment of Smith's business. The $500 paid for the steers and calves is allowable as an expense. (Note 2, below)

The $2,000 paid for a tractor and the $150 for a feed-cutting machine represent investment in equipment and are not deductible. (Note 4, below)

The $550 which Smith put into an addition to his barn cannot be deducted. It represents a further investment in farm equipment. (Note 5, below)

The $2,000 received by Smith in payment of the principal of a note should not be included by him in his return. It is not income; it represents merely a return of capital to his possession. The two years' interest, however, represents income—the earnings of the capital represented by the principal of the note. (Note 6, below)

Smith's peach trees are only two years old and therefore have not reached a productive stage. No depreciation can be charged on them. However, the cost of bringing them to a stage of production is being lumped in and deducted with other farm expenses; therefore, such carrying charges cannot be added to original price paid for trees to get total cost basis for depreciation when trees do become productive. (Note 8, below)

The beans produced in 1917 need not be accounted for until sold—converted into cash or the equivalent of cash. (Note 1, below)

No account should be taken of the value of hay and corn produced on the farm and fed to animals on the farm. Cost of production is taken care of in general expenses of operating farm.

Smith's Federal income tax of $190, paid in 1917 upon income for 1916 can not be deducted; neither can his irrigation district tax of $320.

[SEE PAR. 81-82.]

Notes

1.—Farm products to be accounted for, returned as income of year when converted into cash. Cost of producing them to be deducted in year of expenditure.

[SEE PAR. 45-46.]

2.—Cost of animals purchased by farmer for resale during year deductible as business expense.

[SEE PAR. 49-78.]

3.—Expense of feeding stock is expense to farmer same as cost of fuel for furnace is to manufacturer.

[SEE PAR. 78.]

4.—Expenditures for ordinary farm tools deductible as expense; but expenditures for farm machinery represent investment.

[SEE PAR. 51.]

5.—Cost of ordinary repairs to business property is allowable as business expense, but not the cost of permanent improvements.

[SEE PAR. 72.]

6.—Interest must be returned as income for year in which received, even though the amount may have accrued for more than one year. A payment received on principal is not income.

[SEE PAR. 32.]

7.—Smith invested $500 of his capital in the bull he bought from his neighbor. The bull was part of his business property. But the investment was wiped out by the accidental death of the bull. Therefore, Smith sustained a business loss by casualty during the year, measured by the cost of the bull, the animal not having been insured.

[SEE PAR. 50-89-91.]

8.—Depreciation allowed on orchard or vineyard only when it has reached stage of production. Assuming that while he was bringing vineyard to stage of production Smith did not keep separate account of expense applied to it as distinguished from the rest of his farm, he cannot add such carrying expense to original cost of vines when they were planted to get cost basis of depreciation. His basis is original cost of vines. Annual rate of depreciation should be ascertained by spreading original cost of vines ratably over their probable life.

[SEE PAR. 99-264-265-273.]

9.—Animals bought for working purposes are business property that depreciate from their use in the business of the owner.

[SEE PAR. 99-264-265-272.]

10.—Depreciation allowable on farm machinery but not on tools. Cost of machinery is basis of depreciation, but is not deductible as expense. Cost of ordinary tools deductible as expense in full in year incurred.

[SEE PAR. 99-264-265-51.]

11.—While Smith has a wife and three children, only two of his children (the two daughters) are under 18 years of age. His exemption under the new law is, therefore, the $2,000 allowed a married man living with his wife, plus $200 for each dependent child under 18 years of age, or $2,400. His exemption under the old law is the $4,000 allowed a married man living with his wife, plus the $200 for each such dependent child, or $4,400.

[SEE PAR. 4 (SUB. PAR. 4) ALSO PAR. 105-106.]

A PHYSICIAN

Dr. Robert Lowe is a practicing physician. He has a wife and small son with whom he lives in a hotel. For more than a year he has resided in the hotel, meantime having rented the family home for $125 a month for more than a year. During 1917 he had to repair plumbing in the house at a cost of $250.

Dr. Lowe collected during the year 1917 $15,000 from the practice of his profession. For services rendered during the year there remained outstanding accounts at the end of the year to the amount of $1,840.

Having been advised of a supposed realty bargain, the doctor in March, 1917, purchased some lots in a townsite on a projected railroad extension, paying for the lots $5,000, but by October the railroad had changed its plans and the boom had collapsed, so the doctor was glad to sell his lots for $500—at a loss of $4,500.

He owns two automobiles—one for the use of Mrs. Lowe and for his own personal use, and the other a roadster used exclusively in his practice. His garage bill for the two cars during 1917 was $30 a month. He used $500 worth of tires, gasoline, oil and sundry supplies on his roadster and $300 worth on his family car. He paid $60 a month rent for his offices, $75 a month for an office nurse and $75 a month for a chauffeur for his wife. His hotel bill for the year was $2,400 and the other bills paid for clothing and entertainment amounted to $1,000. During the year he spent $500 for surgical instruments. His local taxes for the year were $210 and his Federal income tax, paid in June, 1917 on income for the year 1916, amounted to $84. He keeps a number of periodicals in his waiting room, and paid in subscriptions to them for the year $24.

How would Dr. Lowe prepare his return for 1917?

ANSWER

Dr. Lowe's returnable gross income would consist of:

The $15,000 collected from his practice. (Note 1, below)

The $125 a month rent from the family home. (Note 2, below)

His allowable deductions would be:

That part of garage bill and that part of cost of automobile supplies applicable to the roadster car used in connection with the practice of his profession. (Note 3, below)

The $60 a month office rent.

The $75 a month paid his office nurse.

The $24 paid in subscriptions to periodicals for his office.

The $250 spent in repairing plumbing of family home. (Note 4, below)

Local taxes to amount of $210.

Dr. Lowe's net income would be ascertained by subtracting the total of his allowable deductions from the total gross income. He would then be allowed a credit against such net income of the amount of Excess Profits tax, if any, assessed for the year 1917. This would be done before assessment of income tax.

[SEE PAR. 103 AND PAR. 1 AND PAR. 4 (COMPLETE).]

Dr. Lowe's exemption under the new law is $2,200 and under the old law $4,200. (Note 5, below)

His tax would be computed as stated in the example of "A LAWYER-POLITICIAN."

The following expenditures by Dr. Lowe during 1917 were personal, living or family expenses and not deductible: That part of garage bill and cost of supplies applicable to automobile used by his family; $75 a month paid chauffeur to drive for Mrs. Lowe; hotel bill of $2,400; clothing and entertainment bills amounting to $1,000.

Notes

1.—He need return only the amount received during the year. The outstanding accounts left over and amounting to $1,840 can be returned as income for the next year if collected.

[SEE PAR. 15.]

2.—When the family home was rented, it ceased to be the dwelling of the taxpayer and became a business property.

3.—The automobile used by the doctor in his practice is business property and the cost of its care and maintenance is allowable as a business expense.

[SEE PAR. 68.]

4.—The family home having been converted into a business property and no longer being the dwelling of the taxpayer, the cost of ordinary repairs on it to keep it in habitable condition is allowable as a business expense.

[SEE PAR. 72.]

5.—Dr. Lowe is married, lives with his wife and has one small son.

[SEE PAR. 4 (SUB. PAR. 4) ALSO PAR. 105-106.]

6.—The $4,500 loss on townsite lots is not allowable, according to the Treasury Department. Dr. Lowe is not a dealer in real estate, and so the Department would not allow him to deduct the loss or any part of the loss when he made no profit from a similar transaction in 1917.

[SEE PAR. 90-92-93-94.]

7.—The $500 spent for surgical instruments represented an investment in business equipment.

[SEE PAR. 72.]

8.—Dr. Lowe could also claim as a deduction a reasonable allowance for the depreciation of the automobile used in his profession. In the case of surgical instruments rendered obsolete, he might be entitled to a deduction on account of loss.

[SEE PAR. 99-264-265-266.]

9.—His Federal income tax of $84 can not be deducted.

[SEE PAR. 81.]

A WAGE-EARNER

Martin Sanders is an expert machinist and is employed at the Amalgamated Iron Works at $5.50 a day. Counting up on the last payday of the year he found

that he had been paid $1,625 in 1917. He is single, with no one dependent on him for support. He lives at a boarding-house at a cost of $30 a month. He owns no property and pays no taxes. He has no debts. He has no income other than his wages. While his wages have been sufficient to keep him comfortably, he has managed to spend about all he has earned. So pressed is he for funds at the end of the year, he must give up a trip to his old home which would have cost at most only about $75.

Is Sanders required to file a return of income for the year 1917, and, if so, what is his tax?

ANSWER

Sanders' gross income for 1917 was $1,625.

He had no allowable deductions. (Note 1, below)

His net income for 1917 was therefore $1,625. (Note 5, below)

His net income having been $1,000 or more (in his case, more), he is required to file a return of income. (Note 6, below)
His exemption under the new law is $1,000. (Note 2, below)

His taxable income was therefore the difference between his total receipt of income and his exemption, or $625.

His income was not sufficient for assessment of Excess Profits tax for the year 1917.

His tax would be 2 per cent of $625, or a tax of $12.50.

Notes

1.—All Sanders' expenditures during 1917 were personal and therefore not deductible in ascertaining net income.
[SEE PAR. 69.]

2.—He is single and without dependents. His net income is less than the $3,000 exemption allowed by the old law; hence he is not concerned with that exemption.
[SEE PAR. 4 AND PAR. 5 (SUB.-PAR. 3).]

3.—Sanders had practically no money left at the end of 1917, yet he had a net income, as the law defines the term "net income," of $1,625, of which amount $625, the amount in excess of his specific exemption of $1,000, is subject to income tax for 1917.

4.—The Amalgamated Iron Works will be required to report the payment of $1,625 to Sanders in 1917 and give his name and address. If Sanders does not, therefore, file a return of income not later than March 1, 1918 he will be liable to penalty when later the officers of the Government call upon him for an explanation as a result of the report filed by his employer.
[SEE PAR. 158 (SUB.-PAR. 5) AND CHAP. VIII.]

5.—Net income is the difference between gross income and allowable deductions. The specific exemption is not considered in ascertaining net income.
[SEE PAR. 1.]

6.—Every single person, who is a citizen or resident of the United States, is required to file a return under the new law if his net income is $1,000 or more for the year.

[SEE PAR. 112.]

A MILLIONAIRE

John Templeton is worth millions of dollars. He is recognized as a multimillionaire. He resides in a palatial home surrounded by acres of garden. He entertains with a lavish disregard of cost. He owns vast tracts of city and suburban lands, and late in the year 1916 succeeded in gaining control of an elaborate street railway system. During 1917 he extended the lines of this system into his suburban lands and has been subdividing, improving and parking the properties with the purpose of selling at large profits. That he will realize the expected profits seems assured.

Templeton is a widower. With him reside his son, 28 years of age, who is associated with him in business, and his daughter and her husband.

Late in 1916, in his fight to get control of the street railway system, Templeton's expenditures were so heavy that he drew on his fortune for $3,000,000. This was cash and he had to borrow $1,000,000 of it at 7 per cent. On December 1, 1917 he made his first annual interest payment on this loan, paying at that time $70,000. During 1917 he paid local taxes on his real estate amounting to $128,510. From a mining property in the Arizona copper section he received dividends of $110,000. On Atlantic Railroad bonds paying 5 per cent, his holding amounting to $600,000 par value, he collected a year's interest on December 1, 1917. He had bought the bonds two years before at 102. Being pressed for ready cash late in 1917, he sold half his holding at the price he had paid, receiving therefor $306,000. From an office building he received during 1917 gross rents of $124,000. The maintenance of the building—janitors, fuel, incidental repairs and elevator service—cost $32,000.

Templeton at the close of the year was happy in the prospect of big returns from his street railway and suburban land proposition. Business opinion was that he had played a shrewd hand, with a certainty of a material increase of his fortune.

During the year 1917 through his control of the street railway company he had all the earnings of the company put into the extension of its lines.

What kind of a return of income would Templeton file for 1917?

ANSWER

Templeton's returnable gross income would consist of:

Dividends from Arizona mine	$110,000	
One year's interest Atlantic Railroad bonds at 5 per cent	30,000	
Rent from office building	124,000	
Total returnable gross income		$264,000

His allowable deductions would be:

Expense of maintaining office building	$ 32,000	
Local taxes	128,510	
Interest on $1,000,000 loan	70,000	
Depreciation office building at 2½ per cent on cost of $1,300,000	32,500	
Total allowable deductions		$263,010

Templeton's net income for the year 1917 would be the difference between total gross income and total allowable deductions ($264,000 minus $263,010), or $990

Templeton is a single man.
[SEE PAR. 106.]

His exemption under the new law is $1,000 and under the old law $3,000. He is single, being a widower, and neither his son nor his daughter is dependent upon him for support.
[SEE PAR. 4 (SUB.-PAR. 4) AND PAR. 105-106.]

Templeton is not even required to file a return of income for the year 1917.
[SEE PAR. 112.]

Notes

1.—He made no profit from the sale of half his Atlantic Railroad bonds, having sold at 102, the price he had paid, therefore no part of the $306,000 received for the bonds should be accounted for as income.

2.—One purpose of this illustration is to show how it is income (net income) and not capital, which is subject to tax.

A SALARIED MAN

Walter Stimson is sales manager for the Western Steel Company at a salary of $4,000 a year. He and his wife, there being no children, live in a cottage which they have been buying on the installment plan. On December 6, 1917 the last payment of $500 was made.

Pursuant to practice, the company paid Stimson on February 12, 1917, a bonus of $400 in recognition of his efficient service during the year 1916. Mrs. Stimson had an income of her own of $50 a month in rent from property inherited by her several years before.

Household expenses during the year 1917 were $2,400, club dues for Stimson and his wife $120 and wearing apparel $720. The two went away for a vacation in the summer and on the trip spent $300.

In January, 1917, Stimson bought two lots of mining stock, paying $500 for each lot. One lot he sold in August for $200 and the other in November for $300. Stimson paid local taxes for the year amounting to $112 and a street improvement assessment amounting to $64.

What is Stimson's income tax for 1917, and how would he make the computation?

ANSWER

Stimson's gross income consisted of:

His salary	$4,000	
Bonus received in February (Note 1, below)	400	
Rent received by wife (Note 2, below)	600	
Total gross income		$5,000

His allowable deductions were:

Local taxes. (Note 3, below)	$ 112

His net income was:

Difference between $5,000 and $112 (Note 3, below)	$4,888

His net income was not sufficient for assessment of Excess Profits tax for 1917.

Stimson's exemption was:
$2,000 under new law and $4,000 under old law. (Note 4, below)

His net income subject to tax was: (Note 5, below)

$2,000 at 2 per cent, tax being	$40.	
$888 at 4 per cent, tax being	35.52	
Total income tax		$75.52

The following expenditures by Stimson were personal, living or family expenses and not deductible: Payment of $500 on purchase of home; household expense of $2,400; club dues of $120; cost of wearing apparel $720; Cost of summer vacation $300.

Notes

1.—A bonus received pursuant to practice and for service rendered is not a gift; it is additional compensation and is to be included in a return. Moreover, it should be included in return for the year in which received, regardless of when service was rendered.

[SEE PAR. 16-225.]

2.—In case of this kind husband and wife should make joint return. This return must include income of both. It is not necessary, however, that both sign the return. The husband's signature is sufficient. If the net income of both husband and wife is in excess of $5,000, separate returns should be made by them and attached when filed. The reason for this is that the income of each individual is considered by itself in assessing the additional tax applicable to all net income in excess of $5,000.

[SEE PAR. 303.]

3.—Stimson's payment of $64 as a street improvement assessment is not deductible. It is a tax "assessed against a local benefit."

[SEE PAR. 81-82.]

4.—Stimson is married and lives with his wife. They have no children and, presumably, no others dependent upon them for support.

[SEE PAR. 4 (SUB.-PAR. 4) AND PAR. 105-106.]

5.—The new law rate of 2 per cent applies to net income between the amount of the new law exemption and the amount of the old law exemption. The combined rates of the old and new laws apply to net income in excess of the old law exemption.

[SEE PAR. 4 (SUB.-PAR. 5).]

6.—Stimson can not, according to the Treasury Department, deduct his losses on mining stock.

[SEE PAR. 90-92-93-94.]

7.—Stimson has probably filed returns in other years. If he has not, he should file one for the year 1917. The Government will learn of the payment made to him by the Western Steel Company and at the same time get his name and address. If he does not file a return not later than March 1, 1918, he will be called upon to explain and will then be liable to penalty.

[SEE PAR. 158 (SUB.-PAR. 5) AND CHAP. VIII.]

A MERCHANT

Isidor Kurtzman has a clothing store. He is not living with his wife. He lives at his club and his wife in an apartment of her own. They are not

divorced, but he pays her $150 a month separate maintenance. They have no children.

Kurtzman's store stock inventoried at the end of the year 1916 at $64,000, cost. During the year 1917 he made purchases of merchandise to the amount of $165,000 and his sales during the year totaled $213,000. His inventory at the end of 1917, taken at cost, showed stock on hand of $68,000. For rent, clerk hire and sundry store expenses he paid out $10,000. His total payments for taxes amounted to $680, included in the amount being a Twin Peaks Tunnel assessment of $110 paid in San Francisco and a Federal income tax paid in June, 1917, of $78. He also wrote off accounts due to the amount of $1,100, having made every possible effort to collect them. During the year he paid a bank interest to the amount of $600.

How would Kurtzman prepare his return for 1917?

ANSWER

Kurtzman's gross income would be ascertained as follows:

Sales during 1917	$213,000	
Stock on hand at close of 1917 (cost)	68,000	
		$281,000
Purchases during 1917	$165,000	
Stock on hand at close of 1916 (cost)	64,000	
		$229,000
Gross income from store		$ 52,000

His allowable deductions would be:
The $10,000 paid for rent, clerk hire and sundries.
Also $492 of his taxes. (Note 1, below)
The $600 interest paid bank.
The $1,100 in bad debts charged off. (Note 2, below)

Kurtzman's net income would be ascertained by subtracting the toal of his deductions from his gross income. He would then be allowed a credit against such net income of the amount of Excess Profits tax, if any, assessed for the year 1917. This would be done before assessment of income tax.
[SEE PAR. 1-103.]

Kurtzman's exemption is $1,000 under the new law and $3,000 under the old law. (Note 3, below)

The following expenditures by Kurtzman were of personal, living or family character and not deductible in his return: His own living expenses at his club; the $150 a month separate maintenance paid his wife.
[SEE PAR. 69-44.]

The $110 paid as Twin Peaks Tunnel assessment was a tax "assessed against a local benefit" and therefore not deductible.
[SEE PAR. 81-82.]

The $78 Federal income tax paid in 1917 it not deductible.
[SEE PAR. 81.]

Notes

1.—Of Kurtzman's total expenditure for taxes, two items are not allowable —Twin Peaks Tunnel assessment and Federal income tax.

[SEE PAR. 81-82.]

2.—Bad debts are allowable as a deduction for the year in which ascertained as worthless and charged off.

[SEE PAR. 98.]

3.—Although married, Kurtzman and his wife do not live together. The fact that he supports his wife in separate maintenance makes no difference. He has no one else dependent upon him for support. He is not, therefore, the head of a family. His status for income tax purposes is strictly that of a single man without dependents.

[SEE PAR. 4 (SUB.-PAR. 4) ALSO PAR. 105-106-107.]

A RETIRED MAN OWNING "TAX-FREE" BONDS

Philip Klein has retired from active business but retains his investments in various properties and his interest in a partnership conducting a jewelry business. With him live his wife and an invalid brother, who is dependent upon him for support.

The jewelry partnership closed its books on December 31, 1917. It did not, however, make a distribution of its earnings, no one of the partners being in need of money. The books of the partnership showed net earnings for the year ending December 31 amounting to $75,000. There are three partners, with equal interests.

Klein has $20,000, par value, in Central Power Company bonds, paying 6 per cent and guaranteed "tax-free," and $30,000 in Inter-cities Electric Railway bonds paying 6 per cent and not guaranteed against deduction for taxes. He received during the year 1917 $210,000 in dividends from a tungsten property operated by a corporation. He does not maintain an office, but keeps up his business connections, which are not active, from his residence and his club. He does, however,, employ a secretary whom he pays $1,800 a year. Having accumulated a fortune, he responded generously to the war call of the Red Cross, Young Men's Christian Association and Knights of Columbus during the year, giving to each organization $30,000.

His local taxes were $6,400 and his Federal Income tax $1,250, paid in 1917. He paid no interest. His only other expenses were those of his household.

How should he collect his bond interest?

Also how would he prepare his income tax return for 1917?

ANSWER

Klein's returnable gross income for 1917 would consist of:
$25,000 from jewelry partnership (Note 1, below)
Interest at 6% on $20,000 Central Power bonds. (Note 4, below)
Interest at 6% on $30,000 Electric Railway bonds.
$210,000 in tungsten dividends. (Note 2, below)

His allowable deductions would be:
$1,800 paid secretary during year.
$6,400 local taxes.
Only $34,470 of the total amount of $90,000 given during the year to the Red Cross, Y. M. C. A. and K. of C. (Note 3, below)

Klein's net income would be ascertained by subtracting the total of his allowable deductions from the total of his gross income. He would then be allowed a credit against such net income of the amount of Excess Profits tax assessed for 1917. He would next be allowed a second credit for one-third of the Excess Profits tax assessed against the jewelry partnership. These two credits would be taken before assessment of income tax. From the amount of net income remaining, after the allowance of the two Excess Profits credits, there should be deducted the $210,000 in dividends. Then, on the amount remaining after that deduction, if any in excess of $2,000, should be computed the normal income tax; only so much, however, as might be in excess of $2,000 would be subject to such normal tax computation.
[SEE PAR. 1-103-104 AND PAR. 4 (COMPLETE).]

The amount of net income subject to the additional tax would be the amount shown by the return (difference between gross insome and allowable deductions) less the two Excess Profits Tax credits—that is, without deducting the $210,000 in dividends.
[SEE PAR. 4 (SUB.-PAR. 7) ALSO PAR. 104-306.]

Klein's exemption is $2,000 under the new law and $4,000 under the old law. (Note 5, below)

The following expenditures by Klein during 1917 were personal, living or family expenses and are not deductible: All the expenses of his household and all personal expenses for himself, his wife and his invalid brother.
[SEE PAR. 69.]

Notes

1.—The law requires that each partner include in his individual income tax return his share of the net earnings of a partnership, whether such earnings have been distributed or not. A partner's share is returnable when it has been ascertained.
[SEE PAR. 57-140.]

2.—Klein must include his dividends in his statement of gross income but, as explained above, is allowed to deduct them from net income for the purpose of the normal income tax. Such dividends, however, go back into the computation for the purpose of the additional income tax, as also explained above.
[SEE PAR. 104-306.]

3.—Klein's gross income for 1917 was $238,000. Without considering any part of his donations to charitable and religious organizations, (that is, by deducting only the $1,800 paid his secretary and the $6,400 local taxes) his net income would be $229,800. Taking 15 per cent of $229,800, we have $34,470. This amount ($34,470) is the limit imposed by law upon Klein's deduction of donations to the Red Cross, Y. M. C. A. and K. of C.
[SEE PAR. 101.]

4.—Klein signed ownership certificates claiming exemption when he collected his interest on his Central Power bonds, with the result that he must account for the interest as income which has not been taxed at the source, Klein must pay the tax; the Government will not look to the Central Power Company. That corporation has already sent in Klein's ownership certificates claiming exemption and has thereby been relieved of liability for the tax at the source. Klein must pay the tax despite the guaranty in the bonds. On the

other hand had Klein signed ownership certificates in which he did not claim exemption, he could enter the interest in his return as having been taxed at the source and get credit to that extent for the normal tax computation. Without ownership certificates claiming exemption, the Central Power Company would have to pay the tax to the Government.

[SEE PAR. 148-304.]

5.—Klein is married and lives with his wife. The fact that he supports an invalid brother does not give him the additional exemption of $200. The additional exemption is allowed only for dependent children of the taxpayer.

[SEE PAR. 4 (SUB.-PAR. 4) ALSO PAR. 105-106.]

6.—Klein is not allowed deduction for his Federal income tax of $1,250, paid in 1917 on income for 1916.

[SEE PAR. 81.]

7.—Klein can not deduct in his return any of the expenses of the jewelry partnership. Such expenses were covered when the partnership determined its net earnings, a third of which net earnings became an item of Klein's gross income.

[SEE PAR. 70.]

A LAWYER-POLITICIAN

Barclay Emerson is a lawyer in active practice. He is a bachelor. During the year 1917 he received in fees and retainers $42,000. Of this amount, however, $2,000 was for an old case ended five years before. He had come to the conclusion that this would never be paid, but had left the account open on his books. His client had been his personal friend and for that reason he had not pressed the matter. His only other income during the year consisted of $600 in interest on Western Railway Company bonds.

He employed a stenographer at $90 and a law clerk at $125 a month during the entire year. His rent was $75 a month. He bought $250 worth of law books. Having prospered during the year, he made a sister a Christmas present of $500 and at the same time gave to the Associated Charities $100.

In the summer of 1917 he thought the interests of the public demanded that he enter public life, and so he made the race for Supervisor of San Francisco that fall. He spent $1,500 of his own money in the campaign, to say nothing of what others spent, but the public did not seem to agree with him and he was defeated.

How would Emerson prepare his return for 1917?

ANSWER

Emerson's gross income for 1917 was:

Total retainers and fees received during 1917 to amount of $42,000. (Note 1, below)

The $600 in interest on Western Railway bonds. (Note 4, below)

His allowable deductions were:

The $90 a month paid stenographer.

The $125 a month paid law clerk.

The $75 a month rent.

Donation of $100 to Associated Charities. (Note 2, below)

Emerson's net income would then be ascertained by subtracting the total of his allowable deductions from the total of his gross income. He would then be allowed a credit against such net income of the amount of Excess Profits tax assessed for the year 1-917. This would be done before the assessment of income tax.

[SEE PAR. 103 AND PAR. 4 (COMPLETE).]

Emerson's exemption is $1,000 under the new law and $3,000 under the old law. (Note 3, below)

His normal tax liability would be determined as follows:

(a) Deduct from net income amount of Excess Profits tax assessed for 1917.

(b) On amount of net income remaining figure normal tax—2% on $2,000 between new law exemption of $1,000 and old law exemption of $3,000; then 4% on amount exceeding old law exemption of $3,000.

Emerson's additional tax would then be determined by subjecting to the rates of the new and old law the amount of net income as shown by the difference between gross income and deductions (less Excess Profits tax) in excess of $5,000.

[SEE PAR. 4 (SUB.-PAR. 7) ALSO PAR. 104-306.]

The following expenditures by Emerson were for personal or living expenses and cannot be deducted: Any living expenses for the year,, and his political campaign expense of $1,500. (Note 5, below)

Notes

1.—The $2,000 fee earned years before but not paid until 1917 must be returned as income belonging to 1917.

[SEE PAR. 15.]

2.—This donation is allowable because made to a charitable organization and not in excess of 15 per cent of what Emerson's net income would be without deducting it. The $500 Christmas gift to his sister is not deductible, for the reason that it is a gift and was not made to a charitable, religious or educational organization or a society for prevention of cruelty to children or animals.

[SEE PAR. 101.]

3.—Emerson is single and has no dependents.

4.—The Western Railway bonds are not "tax-free" and there was no deduc-
[SEE PAR. 148.]
tion of tax at the source.

5.—Such a political expense is not a necessary expense of Emerson's busi-
[SEE PAR. 68.]
ness.

6.—The $250 spent in buying law books was an investment in business equipment, and not deductible.

[SEE PAR. 72.]

STOCKHOLDER OF A BANK

Howard Carson owns 100 shares, par value $100 a share, of the Western Banking and Trust Company. He is making up his income tax return for the year 1917 and has it almost completed. He has not, however, made entry of the amount received during the year as a dividend on the stock of the bank. He

is just about to do so when he recalls that some time back he received a little printed slip from the bank, notifying him that the bank had paid to the State of California a tax assessed against the capital stock of the bank and amounting to $1.05 a share. He did not pay much attention to the slip at the time but finally locates it. His dividend from the bank during the year, received in actual cash, totaled $800.

What should he do in making up his return?

ANSWER

Carson should add $105 to the amount of his deduction for taxes paid during 1917 in his own return.

Then he should add $105 to the amount of his bank dividend—that is, increase the amount of the dividend from $800 to $905—and enter the dividend in his return at $905.

The Government holds that the payment of the tax by the bank on the shares owned by Carson is merely an accomodation extended the stockholder; that the bank cannot deduct the tax in its return but that the stockholder can, according to the number of shares he owns. But if the bank had not been required to pay a tax of $105 on Carson's shares it could have paid him $905 instead of $800 as a dividend; therefore, Carson must add the $105 to his dividend.

[SEE PAR. 30-84—ALSO PAGE 135.]

A HOLDING COMPANY

The Nevada Silver Company operates a highly productive mining property and declared and paid dividends to the amount of $800,000 during the year 1917. Such dividend payments did not, however, represent all its net earnings for the year, a portion having been added to surplus. The company early in January, 1918, makes an income tax return showing a net income for 1917 of considerably over a million dollars.

A stock-holding company, known as the Nevada Company, has been organized and is being maintained. Its income consists entirely of the dividends paid by the Nevada Silver Company. Its expenses are inconsiderable. Assume, for the purpose of this example, that they are nothing.

The entire gross income of the Nevada Company, as a part of the net income of the Nevada Silver Company, must bear the income tax in the assessment against the Nevada Silver Company—the 2 per cent of the old law and the 4 per cent of the new law.

Must this income (which is, for all practical purposes, both the gross and the net income of the holding company) again be taxed 6 per cent in an assessment against the Nevada Company in view of the requirement of the law that every corporation maintaining a corporate existence must make a return?

ANSWER

Prior to enactment of the law of October 3, 1917, the Nevada Company would have been required to pay the full income tax on its own net income. Its net income being the same as its gross income, and its gross income having

come directly from subjection to the full income tax in the assessment against the net income of the Nevada Silver Company, there was a double taxing of the income from the mining property in its passage to the real parties at interest, the stockholders of the Nevada Company (the holding company).

In the Act of October 3, 1917 partial relief has been provided.

The Nevada Company must, as usual, file a return and account for the dividends it received from the Nevada Silver Company during 1917. There is no relaxation of requirements in this respect.

But the double taxing is enforced only to the extent of the 2 per cent rate of the old law. The Nevada Company is allowed a credit for the amount of dividends received from the Nevada Silver Company as far as the 4 per cent rate of the new law is concerned. Such credit would wipe out its net income and the Nevada Company would not have the 4 per cent rate to pay.

[SEE PAR. 176-184 AND PAR. 6 (COMPLETE).]

CHAPTER XXVI

EXCESS PROFITS TAX

[Note:—Congress will be asked at its approaching session, beginning in December, to amend the Excess Profits Tax law in a number of particulars. What will be the response can not be foretold. Certainly, however, the law ought to be amended for the sake of simple equity and justice. In the event of amendment, changes made necessary in the ensuing chapter will be covered by a supplement.]

The Excess Profits Tax, imposed by the War Revenue law, Act of October 3, 1917, is a tax in addition to all other taxes imposed by Federal laws.

The language of the law is admittedly clouded and ambiguous—so vague, indeed, that at the time this book went to press no attempt had been made by the Treasury Department to interpret it. In fact the Department was at that time declining to answer questions regarding the meaning of the law and had even, by blanket order, extended until January 1, 1918, the time for filing Excess Profits Tax returns required in connection with Income Tax returns for fiscal years ending more than 60 days prior to the end of the calendar year 1917. And meantime the Secretary of the Treasury had announced that he would summon to Washington several of the foremost lawyers and business experts of the nation to serve on a board of interpretation. With its meaning thus obscured, Congress turned the law over to the Treasury Department for enforcement and the result is almost sure to be a continuous changing, shifting and reversal of interpretation during the early part of 1918. That is what transpired when the first Income Tax law of 1913 went into effect, and the chances are a hundred to one that the taxpaying public will have the same experience in connection with the Excess Profits Tax law.

Obviously it was the intent of Congress to impose this tax upon profits of the war years, beginning with 1917, in excess of those earned during the three years—1911, 1912 and 1913—immediately preceding the year 1914, in which the great world war began.

There are three basic considerations involved in the computation of this tax. The first is net income as ascertained for Income Tax purposes; the second is the return from invested capital in the predar period; the third is the return from invested capital in 1917 and subsequent years. Such is the general scheme proposed by Congress for taxing abnormal profits realized in 1917 and subsequent years, but the law reaches out much farther. It does not stop with the taxing of war profits; its application is not restricted to business benefited by the war; it is not balked even by a lack of invested capital. It covers the income from trades and professions in excess of certain specified amounts and becomes, in plain reality, still another tax upon income. Thus the scheme of assessment belies both the title of the law and the evident intent of Congress.

But notwithstanding that the method of computation and assessment prescribed is not only clumsy and awkward but also unscientific, it is believed that, from experience in administering the Income Tax and other involved Federal revenue statutes, an interpretation of the law can be given and instructions for compliance with it offered which can be safely followed.

In the chapters on Income Tax the principal basis of computation has been thoroughly explained and illustrated.

387.—THOSE AFFECTED.

With certain exemptions as to character of business and certain exceptions with respect to amount of income, hereinafter explained, the Excess Profits Tax is applicable to:

(a) Individuals, who are citizens or residents of the United States.
(b) Individuals who are non-resident aliens.
(c) Partnerships, both domestic and foreign.
(d) Corporations, both domestic and foreign.

388.—THOSE EXEMPT.

Specifically exempted from the application of this Excess Profits Tax are:

(a) Any corporation exempt under the Income Tax law. (For complete list see chapter headed "Corporations Exempt.")

(b) Any partnership engaged in the same character of business as any one of the corporations just referred to.
(c) Any individual engaged in the same character of business as any one of the corporations just referred to.
(d) Officers or employees of the United States, or of any State, territory or the District of Columbia, or any local sub-division of a State or territory, as far as their official compensation is concerned, but no farther.

389.—ALL OTHERS AFFECTED.

Any individual, partnership or corporation, unable to qualify for exemption under one of the above provisions and in receipt of a net income in excess of the deduction, hereinafter explained, is affected by the Excess Profits Tax.

390.—PARTNERSHIPS TAXED.

One point of significance is that a partnership is taxed under the Excess Profits Tax schedule. A partnership is not subject to Income Tax (either ordinary or war) but, as a taxable entity, comes under the Excess Profits Tax schedule. A partnership will, therefore, have to be prepared to file a return showing its net income and its invested capital, not only for the year 1917, but also for the years 1911, 1912 and 1913, or for all of such years as it was in existence the entire year. This return will be used by the Government as a basis of assessment of the Excess Profits Tax.

391.—INDIVIDUALS REGARDLESS OF KIND OF BUSINESS.

Another point of significance is that all individuals who can not qualify for exemption, as explained above, and whose income is sufficient to make them liable, as hereinafter explained, are subject to the Excess Profits Tax. This includes professional men, capitalists, salesmen, and all others, without regard to their activities or employment.

392.—LAW TAKES IN ALL.

The language of the law is that "the terms 'trade' and 'business' include professions and occupations," and that "every corporation or partnership not exempt shall be deemed to be engaged in business, and all the trades and businesses in which it is engaged shall be treated as a single trade or business."

393.—THE "TAXABLE YEAR."

As the law repeatedly refers to the "taxable year," its meaning must be understood.

In the case of an individual, the first "taxable year," under the Excess Profits Tax, is 1917; and thereafter it is each calendar year ending December 31.

In the case of a corporation or partnership, the first "taxable year," under this tax, is 1917, and thereafter each calendar year, except in the case of a corporation or partnership which has fixed its own fiscal year. (See paragrah on "Fiscal-year Return" in Income Tax instructions.) Where such fiscal-year basis governs, the Excess Profits Tax is to be assessed the first year only proportionately as the fiscal year falls within the year 1917. For example: A corporation files returns of income for a fiscal year ending with the last day of August. In such a case the return would include income for the months of September, October, November and December, 1916. The Excess Profits Tax would be computed for the entire fiscal year, but only eight-twelfths of the amount shown by the computation would be assessed. In subsequent annual returns, however, the tax would be assessed upon a full twelve-months basis.

394.—The "PRE-WAR PERIOD."

The next term of the law to be understood is "Pre-War Period."

This means the years 1911, 1912 and 1913, if the individual, partnership or corporation was engaged in trade, business or profession during the whole of all three years. If not, then as many of such years during the whole of which he or it was thus engaged. In other words, the "pre-war period" is always to be reckoned in whole years. It may be all three years, or just 1912 and 1913, or again just 1913.

395.—FOREIGN CONCERNS AND NON-RESIDENT ALIEN INDIVIDUALS.

Foreign corporations and partnerships and non-resident alien individuals are subject to Excess Profits Tax only with respect to net income from sources within the United States.

They are not subject to this tax at all if in receipt of a net income of less than $3000 from the United States for the taxable year.

396.—HOW TO DETERMINE NET INCOME FOR THIS TAX.

The general basis of determining net income for the purpose of the Excess Profits Tax is that explained in the chapters on Income

Tax. However, owing to the fact that the Excess Profits Tax computation extends back to the year 1911, the general Income Tax basis must be adapted in certain particulars to the Excess Profits Tax for three reasons: first, only the income of corporations was subject to tax prior to 1913; second, even since the income of both corporations and individuals has been subject to tax, beginning with the year 1913, there have been changes in the method of ascertaining taxable net income; and, third, partnerships have never been subject to income tax.

It is therefore suggested that the brief instructions that follow be carefully noted:

397.—FOR A CORPORATION.

A corporation can ascertain net income for the Excess Profits Tax computation as follows:

Net Income For 1911

To net income shown by the return made for the year 1911 under the Corporation Excise Tax law of August 5, 1909, add the deduction claimed in that return for the Corporation Excise Tax which was paid in 1911 but which was assessed on the Corporation Excise Tax return filed for the previous year, 1910. (Note—By "net income" shown by a Corporation Excise Tax return is meant the amount of net income prior to deduction therefrom of the exemption of $5,000 allowed a corporation under that law.)

Net Income For 1912

To net income shown by the return made for the year 1912 under the Corporation Excise Tax law of August 5, 1909, add the deduction claimed in that return for the Corporation Excise Tax which was paid in 1912 but which was assessed on the Corporation Excise Tax return filed for the previous year, 1911. The "note" in preceding paragraph is also applicable.

Net Income For 1913

To net income shown by the return made for the year 1913 under the Income Tax law of October 3, 1913, add the deduction claimed in that return for the Corporation Excise Tax which was paid in 1913 but which was assessed on the Corporation Excise Tax return filed for the previous year, 1912. Then subtract that part of the income for the year 1913 which was derived from dividends paid by another corporation subject to income tax.

Net Income For 1917

From net income shown by the return made for the year 1917 under the Income Tax law subtract that part of the income for the year which was derived from dividends paid by another corporation subject to tax. Should the law not be amended this instruction should also be followed with respect to years subsequent to 1917.

398.—FOR AN INDIVIDUAL.

An individual can ascertain net income for the Excess Profits Tax computation by seeing that, for the special purposes of this tax, the method prescribed by the Income Tax law of September 8, 1916, as amended by the Act of October 3, 1917, is conformed to, and by then subtracting from the amount of net income for each year the amount of that year's income derived from dividends paid by a corporation subject to income tax. "Net income," for income tax purposes, includes dividends, a credit for dividends being allowed only in the computation of the normal tax. "Net income," for Excess Profits Tax purposes, does not include dividends.

There are a good many difficulties for individuals in this requirement of the law.

First—Individuals did not make income tax returns for the years 1911 and 1912. Therefore, they must go back and apply to their income of those years the requirements of the Act of September 8, 1916 (as explained in the chapters on Income Tax).

Second—The returns they made for the year 1913 under the first Income Tax law of October 3, 1913, must be revised to meet the requirements of the Act of September 8, 1916.

The individual would therefore ascertain net income for the purposes of the Excess Profits Tax as follows:

FOR 1917—Deduct from net income shown by the Income Tax return the amount of the year's income derived from dividends paid by a corporation subject to income tax.

FOR 1913—Ascertain net income exactly as required for 1917. This means that net income for the entire year 1913 must be ascertained, whereas the Income Tax return filed for 1913 included only income for the ten-months' period of the year beginning March 1 and ending December 31, with deductions allowed on a five-sixths basis. It means also that deductions should be claimed as prescribed for the year 1917 (explained in Income Tax instructions), and not as prescribed for the year 1913. When net income for the year 1913 has

been thus ascertained, deduct the amount of that year's income derived from dividends paid by a corporation subject to income tax.

FOR 1912 AND 1911—No return having been filed net income for each year should be ascertained exactly as required for 1917.

[Note: In 1913 interest paid by an individual on a loan obtained to buy bonds, the interest on which is exempt from income tax, was allowed as a deduction; in 1917 such outgoing interest is not allowed as a deduction. In 1913 no deduction was allowed for contributions to charitable, religious or educational organizations, whereas in 1917 deduction is allowed within a certain limit (explained under appropriate heading in Income Tax instructions). Cognizance may be taken of these changes in the revision of 1913 net income to meet requirements effective in 1917.]

399.—FOR A PARTNERSHIP.

A partnership, not having filed a return of income for the purposes of the Income Tax, would ascertain net income for each of the years 1911, 1912, 1913 and 1917 exactly as an individual, being allowed the same deductions and being called upon to apply to each of the years the requirements effective in 1917. A partnership would also subtract from the amount of net income, ascertained according to Income Tax regulations, the amount of the year's income derived from dividends. A foreign partnership would proceed under the rules applicable to a non-resident alien individual.

400.—GET COPIES OF OLD RETURNS.

The extension of the Excess Profits Tax computation back to the year 1911 makes it very important that—

Every corporation at once obtain copies of its Income Tax return for 1913 and its Corporation Excise Tax returns for 1911 and 1912, if it has not such copies in its files;

Also that every individual at once obtain a copy of his Income Tax return for 1913, if he has not such copy in his possession.

These copies of returns can not be obtained from the local Collector of Internal Revenue for the reason that returns of income are not kept in his office and his records do not contain the essential data. Certified copies can, however, be obtained from the office of the Commissioner of Internal Revenue at Washington, D. C., and written request should be made for them at the earliest possible date. But a copy of a return will be sent by the Commissioner only to the corporation or individual that filed the return, or to an attorney repre-

senting such corporation or individual when the attorney's request is accompanied by evidence of his authority to ask for and receive the copy.

401.—"INVESTED CAPITAL."

Having ascertained "net income," as "net income" for the purpose of the Excess Profits Tax is understood and has been explained to distinguish it from the "net income" upon which Income Tax is assessed, the individual, partnership or corporation should next look into the meaning of "Invested Capital," as defined for the Excess Profits Tax.

Invested capital does not here mean the value of capital employed in a business. It means the capital invested without regard to the value of the property, except when property, tangible or intangible, is paid into the business instead of cash.

Invested capital can not include, for the purpose of the tax computation, any amount of investment represented by those stocks, bonds, or other assets, **the income from which it not subject to the Excess Profits tax.** Neither can it include any money or other property borrowed. Referring, however, to the exclusion of bonds, there is an exception in the law in favor of bonds or other obligations of the United States. Such bonds, if held by the taxpayer, may be counted as a part of invested capital.

The qualifying clause with respect to the exclusion of stocks and bonds from invested capital, is that reading—**"the income from which is not subject to the tax imposed by this title."** By "this title" is meant Title II, the Excess Profits Tax part of the general War Revenue Act of October 3, 1917.

What, in general, are the stocks and bonds, the income from which is not subject to Excess Profits Tax?

In the first place, the dividends received from a corporation subject to income tax are not subject to Excess Profits Tax. Therefore, the stock on which the dividends are paid can not be counted as a part of invested capital. **This exclusion affects the stock of all domestic corporations** and the stock of foreign corporations, in so far as the foreign corporations are subject to the American income tax.

On the other hand, however, a foreign corporation without income from the United States is not subject to the American income tax. Its dividends, therefore, when paid to a domestic corporation or partnership or to a citizen or resident of the United States, are subject to tax, without the offset of a credit. And so it follows that stock

in such a foreign corporation—not being stock the income from which is not subject to Excess Profits tax—is not excluded from invested capital.

As to the bonds that are excluded, the bars seem to be up against all of the public bonds except bonds of the United States. Investments in State, county, municipal, school, irrigation and similar securities, can not be counted as a part of invested capital, because the income from all such bonds is exempt from tax.

But corporation bonds are not excluded. And it makes no difference **whether the corporation bonds are the so-called "tax-free" bonds or not.** The interest upon all corporation bonds is subject to tax; therefore, such bonds can be counted as a part of invested capital.

The invested capital of a corporation or partnership does include:

(a) Actual cash paid in,

(b) Actual cash value, at time of payment, of tangible property received in payment for stock or shares in the corporation or partnership, except that when such property was received in payment for stock or shares prior to January 1, 1914, the actual cash value to be considered is that of January 1, 1914. In no case, however, can tangible property thus received be considered as having an actual value in excess of the par value of th eoriginal stock or shares issued for it.

(c) Paid in or earned surplus or undivided profits employed in the business except undivided profits earned during the taxable year—that is, during the year for which the tax is computed.

(d) Actual cash value, at time of payment, of patents and copyrights received in payment for stocks or shares—such actual cash value never to be in excess of the par value of the stock or shares issued for the patents or copyrights at the time of payment.

(e) Good will, trade marks, trade brands, the franchise of a corporation or partnership, or other intangible property, if specifically paid for either in cash or tangible property—to be considered invested capital only to the amount of cash or the actual cash value, at time of payment, of the tangible property used in payment for such intangible property. However, with respect to the inclusion of such intangible property in invested capital there is imposed the condition that, when purchased prior to March 3, 1917, with shares in the corporation or partnership, issued prior to the same date, the value

of the property can be included in invested capital, not in excess of the actual cash value of the property at the time of purchase or of the par value of the shares issued in payment for it at the time of issue, provided that not more than a 20 per cent interest in the corporation or partnership was issued in payment for the property.

The invested capital of an individual includes:

(a) Actual cash paid into the trade or business.

(b) Actual cash value of tangible property paid into a business at the time of such payment, except that the inclusion shall be at the value on January 1, 1914, in the case of property paid into the business prior to that date.

(c) Actual cash value of patents, copyrights, good will, trade marks, trade brands, franchises, or other intangible property, if paid for specifically in cash or tangible property. The value at which this intangible property can be included in invested capital can never exceed the actual cash paid for it, or, in case payment is made in tangible property, the actual cash value at the time of payment of such tangible property.

The invested capital of a foreign corporation or partnership, or of a non-resident alien individual, is that proportion of entire invested capital, as defined by the law, which the net income from sources within the United States bears to the entire net income from all sources.

402.—ON REORGANIZATION.

The law provides that a trade or business carried on by a corporation, partnership or individual does not lose its business identity with the pre-war period even though reorganized on or after January 2, 1913. Were such business to be considered as another business entirely, it would not have been engaged in business **during the whole** of even one of the three years of the pre-war period (not even the whole of the year 1913). The law provides that if the trade or business after reorganization is substantially a continuation of a trade or business carried on prior to reorganization, the net income and invested capital of the trade or business prior to reorganization (that is, of the predecessor of the reorganized business) shall be considered as the net income and invested capital of the reorganized business.

There is also a provision in the law relative to determination of the invested capital of a trade or business in which a reorganiaztion, consolidation or change of ownership takes place subsequent to March

3, 1917, (date of first act imposing a war tax upon excess profits.) This provision is to the effect that when in the reorganization one-half or more of the interest or control remains in the hands of the same persons, the property paid into the reorganized business can not be included in the invested capital of the reorganized business at a value greater than would have been allowed in computing the invested capital of the absorbed business had such reorganization not taken place.

To illustrate:

The New York Shoe Manufacturing Company had been engaged in business for a number of years when on January 2, 1913, the business was reorganized. All the assets of the company and its business were transferred to another corporation known as the Eastern Shoe Manufacturing Company. The business of this latter company was substantially a continuation of the business of the former company. Were the latter company to be considered alone, it would be found not to have been engaged in business **for a whole year of the pre-war period** comprising the years 1911, 1912 and 1913. But the law provides that, in such circumstances, the net income and invested capital of the New York Shoe Manufacturing Company for the pre-war period shall be taken as the net income and invested capital of the Eastern Shoe Manufacturing Company for the pre-war period, for the purposes of the Excess Profits Tax computation.

To illustrate again:

The partnership of Baker & Co., engaged in the hardware business, decided to take in new capital and extend its activities. On September 1, 1917 (the significance of this date being that it was subsequent to March 3, 1917) the partnership was reorganized, or rather absorbed, and the business was continued under a new partnership of Baker, Dutton & Co. At the time the decision was reached to reorganize and extend Baker & Co. had an invested capital of $90,000. The firm's business had been so successful, however, that it was worth $150,000, at which figure it was turned into the partnership of Baker, Dutton & Co. for a one-half interest in the new firm to be distributed to the members of the absorbed firm of Baker & Co. This value of $150,000 was matched by two new partners putting in $75,000 cash each. The invested capital of Baker, Duton & Co. **for the last four months of 1917** did not, however, become $300,000, the value of the business. Under the Excess Profits Tax law it became $240,000 ($150,000 in cash from the new partners and the assets re-

ceived from Baker & Co., considered at the value of $90,000, for the purposes of the Excess Profits Tax,—the value that would have been allowed in computing the invested capital of Baker & Co. had the reorganization not taken place).

403.—AVERAGE CAPITAL.

The law also states that invested capital for any year means the average invested capital for that year, to be averaged monthly.

To Illustrate: Taking the second example in the preceding paragraph, if the absorbed firm of Baker & Co. was in business in the pre-war period with the same capital of $90,000, which it had prior to reorganization of the business on September 1, 1917, the "invested capital" of Baker, Dutton & Co., for the pre-war period, would, in the computation for the Excess Profits Tax, be considered as $90,000. But the "invested capital" of Baker, Dutton & Co. for the taxable year 1917, would have to be averaged monthly, there having been a change during the year.

For the first eight months of the year 1917, the "invested capital" of Baker, Dutton & Co. would be $90,000, and for the last four months $240,000. The average for the year 1917 would therefore be $140,000.

404.—NET INCOME AND INVESTED CAPITAL FOR TWO PERIODS.

The individual, partnership or corporation must thus ascertain both net income and invested capital for two distinct periods in order to make the Excess Profits Tax computation—first, for the pre-war period; and, second, for the taxable year, the year for which the Excess Profits Tax computation is to be made. Having ascertained net income and invested capital for each of the three years of the pre-war period, the average for those years would be determined and such average would be considered in fixing the varying part of the deduction allowed from net income of the taxable year in the assessment of the Excess Profits Tax.

405.—DEDUCTION ALLOWED.

The deduction allowed is of two parts: one varying, the other an amount fixed by the statute.

An individual, who is a citizen or resident of the United States, is allowed the sum of (1) an amount equal to the same percentage of the invested capital for the taxable year (1917 and subsequent

years) which the average amount of the annual net income of the trade or business during the pre-war period (1911, 1912 and 1913) was of the invested capital for the pre-war period, and (2) the fixed amount of $6,000. The individual is, however, entitled to a minimum allowance of 7 per cent of invested capital for the taxable year and is limited to an allowance of 9 per cent, and should the percentage of the pre-war period be, on the one hand, less than 7 per cent or, on the other, more than 9 per cent, it would be disregarded in favor of the statutory minimum or maximum percentage.

A domestic partnership is allowed exactly the same deduction as an individual who is a citizen or resident of the United States.

A domestic corporation is allowed the sum of (1) an amount equal to the same percentage of the invested capital of the taxable year which the average amount of the annual net income of the trade or business during the pre-war period was of the invested capital of the pre-war period, and (2) the fixed amount of $3,000. A domestic corporation is, however, entitled to the same minimum percentage and is limited by the same maximum percentage of invested capital for the taxable year, as in the case of an individual.

An individual, who is a non-resident alien, is allowed the same deduction allowed a citizen or resident with the exception of the fixed amount of $6,000.

A foreign partnership is allowed the same deduction allowed a non-resident alien individual

A foreign corporation is allowed the same deduction allowed a domestic corporation with the exception of the fixed amount of $3,000.

406.—NOT IN TRADE OR BUSINESS DURING PRE-WAR PERIOD.

The deduction, just explained, is that intended to be generally applicable. It will not apply, however, in all cases and so special provision has been made to the effect that if a corporation or partnership was not in existence, or an individual was not engaged in trade or business during the whole of at least one of the three years of the pre-war period, the deduction shall be an allowance of a flat 8 per of the invested capital for the taxable year plus $3,000 for a domestic corporation, and $6,000 for a domestic partnership or for an individual who is a citizen or resident of the United States.

407.—RATES OF TAX.

The deduction should be borne in mind in connection with the scheme of assessment. The law states that the tax shall be at the

following percentages of net income for the taxable year (1917 and subsequent years):

20 per cent of the amount of the net income in excess of the deduction and not in excess of 15 per cent of the invested capital for the taxable year.

25 per cent of the amount of the net income in excess of 15 per cent and not in excess of 20 per cent of such capital.

35 per cent of the amount of the net income in excess of 20 per cent and not in excess of 25 per cent of such capital.

45 per cent of the amount of the net income in excess of 25 per cent and not in excess of 33 per cent of such capital.

60 per cent of the amount of the net income in excess of 33 per cent of such capital.

408.—DEDUCTION ONLY FOR FIRST RATE.

The deduction provided for Excess Profits Tax purposes is allowable only for the tax at the rate of 20 per cent; that is, the deduction is to be taken into the computation only in the first step of the graduated tax scale.

409.—TAX WHEN THERE IS NO INVESTED CAPITAL.

The above tax schedule is effective where the allowable deduction can be based either upon the application of the pre-war relation between net income and invested capital to invested capital for the taxable year or upon the flat allowance of 8 per cent of invested capital for the taxable year. But when neither of those bases of deduction can be found it is not effective. Consequently, the law provides that when a trade or business has no invested capital, or has a mere nominal capital, instead of assessment according to the graduated scale, there shall be paid a tax of 8 per cent upon net income in excess of a deduction of $6,000 allowed individuals, who are citizens or residents of the United States, $6,000 allowed domestic partnerships, $3,000 allowed domestic corporations, and upon the net income of non-resident alien individuals and foreign partnerships and corporations without deduction.

410.—TAXPAYER CAN COMPLAIN AND ASK REVISION.

And still other special provisions cover the case of the business of the domestic corporation or partnership, or individual citizen or

resident, when

(1) There was no net income during the pre-war period, or

(2) The return on capital was low as compared with the return of others in a similar line of business, or

(3) The Government is unable to determine to its satisfaction what was the net income for the pre-war period.

In any of such circumstances, the Treasury Department can determine the allowable deduction according to the return on capital in similar lines of business during the pre-war period, adding to such return the fixed amount of $6,000 for an individual or partnership or $3,000 for a corporation.

Any taxpayer, not satisfied with a deduction based upon the return on capital for the pre-war period, as determined by the net income during that period from his own business, may file protest with the Department and ask that his assessment (or the assessment of the partnership or corporation) be made with deduction based upon the larger returns of similar kinds of business during the pre-war period. In order to claim this larger measure of deduction (and therefore a decrease in tax) he would have to file return with the deduction computed according to his own pre-war income. He would not, however, be required to pay all of the tax. Against that part of the tax considered by him to be in excess of the tax computed according to the pre-war return of similar kinds of business, he could file a claim on what is known as Claim Form 47. The filing of this claim would hold collection of the excess in abeyance pending the Department's action upon his request for revision of assessment. Such claim would have to be filed at the time of making the return. It would be filed with the local Collector of Internal Revenue for transmission to the Department.

411.—CAN APPLY AVERAGE DEDUCTION.

Or, should the Department be unable to determine to its satisfaction the invested capital of any business, it can grant to that business the average deduction allowed other representative businesses of the same kind.

412.—PARTNERSHIPS MUST FILE RETURNS.

A return for assessment of this tax is required of every domestic partnership having a net income for the taxable year of $6,000 or more, and every foreign partnership having a net income of $3,000 or more.

413.—RETURN FOR EXCESS PROFITS TAX.

Liability to Excess Profits Tax is to be disclosed at the same time that liability to Income Tax is disclosed. Unless prior to January 1, 1918, the plans of the Treasury Department are changed, only one return will be required for both the Income Tax and the Excess Profits Tax. The individual or the corporation will add to the Income Tax return the additional data essential to assessment of Excess Profits Tax. The partnership will have to file a return, specially prepared for the Excess Profits Tax, owing to the fact that it is not subject to Income Tax.

This disclosure of liability must be made by filing return not later than March 1, 1918, for the calendar year 1917, and not later than March 1, thereafter, for the preceding calendar year. In the case of a corporation or partnership filing according to its own fiscal year, the return must be filed not later than 60 days after the close of such fiscal year.

Otherwise, all the requirements of the Income Tax law relative to disclosure of liability and payment of tax, and penalties for non-compliance, are applicable to the Excess Profits Tax.

414.—PHILIPPINES AND PORTO RICO.

Under the Excess Profits Tax law residence in the Philippine Islands or Porto Rico is not considered residence in the United States. An alien, therefore, residing in the Philippines or Porto Rico, is a non-resident alien. A corporation or partnership created under the laws of either the Philippines or Porto Rico is a foreign corporation or partnership. The term "United States" means only the States, the Territories of Alaska and Hawaii and the District of Columbia.

415.—WHEN INTEREST ON LIBERTY 4'S MUST BE INCLUDED.

If an individual, partnership or corporation holds Liberty Loan bonds of the second series, or any certificates of the United States issued subsequent to September 1, 1917, in sufficient amount to make the aggregate principal exceed $5,000, then the interest received upon the amount of principal in excess of $5,000 must be taken into account in connection with the computation of the Excess Profits Tax. After having ascertained "net income," for the purposes of the Excess Profits Tax, as already explained in this chapter, the holder of the bonds, or certificates, may add to the amount of such "net income" the amount of interest received upon the principal in excess of $5,000.

The result would be "net income," for the purposes of the Excess Profits Tax, in the case of any person, partnership or corporation holding bonds of an aggregate principal of more than $5,000. Up to and including an aggregate principal of $5,000, however, the interest paid upon these bonds, or certificates, is exempt from Excess Profits Tax.

416.—ILLUSTRATIVE CASES.

A few illustrations of tax computation to emphasize salient features of the law have been worked out in the examples that follow.

The examples deal, mainly, with corporations. An example can, however, be adapted to the case of a domestic partneship or an individual who is a citizen or resident of the United States by adding a fixed allowance of $6,000, instead of $3,000, in determining the total allowable deduction.

A foreign corporation or partnership, or non-resident alien individual would not be allowed any fixed amount of $3,000 or $6,000 in determining the deduction.

Also, no adaptation can be made to the case of an individual when a fiscal-year basis of filing is involved. Only a corporation or a partnership can file according to a year ending with the last day of some month other than December. An individual must file for the calendar year.

The illustrations follow:

No. 1

(Capital the same; slight increase in earnings)

The average invested capital of a corporation for the pre-war period (1911—1912—1913) was $100,000. Its average net annual earnings for that period were $8,000. Thus its percentage of return on capital was 8 per cent. Its invested capital in 1917 is the same ($100,000). Its net income for the year 1917 is $10.000.

To get deduction:

Take 8 per cent of invested capital of 1917. Eight per cent of $100,000 is $8,000. To this add the fixed allowance of $3,000. The total deduction is therefore $11,000.

This deduction is in excess of net income for 1917, and so there is no tax at the 20 per cent rate.

The net income for 1917 is not in excess of 15 per cent of the invested capital for that year, and so there is no tax at the 25 per cent rate.

There is no Excess Profits Tax at all.

No. 2

(Capital the same; illustrating restriction to the maximum of 9 per cent)

The average invested capital of a corporation for the pre-war period was $100,000. Its average net income for that period was $10,000. Thus its percentage of return on capital was 10 per cent. Its invested capital for 1917 is the same ($100,000). Its net income for 1917 is $25,000.

To get deduction:

The full percentage of the pre-war period can not be used. Nine per cent is the maximum. Therefore, take 9 per cent of $100,000. To the amount of $9,000 thus obtained add $3,000, the fixed allowance. The result is $12,000, the total allowable deduction.

To compute tax:

20 per cent of the amount of net income in excess of the deduction ($12,000) and not in excess of 15 per cent of invested capital for 1917 ($15,000) means that $3,000 is subject to the 20 per cent rate, the tax being	$ 600
25 per cent of the amount of net income in excess of 15 per cent ($15,000) and not in excess of 20 per cent ($20,000) of invested capital for 1917 means that $5,000 is subject to the 25 per cent rate, the tax being	1,250
35 per cent of the amount of net income in excess of 20 per cent ($20,000) and not in excess of 25 per cent ($25,000) of invested capital for 1917 means that $5,000 is subject to the 35 per cent rate, the tax being	1,750
Total tax	$3,600

No. 3

(Capital the same, but great increase in earnings; illustrating allowance of minimum percentage—also right of appeal)

The average invested capital of a corporation for the pre-war period was $1,000,000. Its average net income for that period was only $60,000 a year. Thus its percentage of return on capital was only 6 per cent. Its invested capital for 1917 is the same ($1,000,000). Its net income for 1917 is $400,000.

To get deduction:

The minimum percentage of 7 per cent can here be claimed. Therefore, disregard the pre-war percentage of 6 per cent, and take 7 per cent of $1,000,000. To the amount of $70,000 thus obtained add $3,000, the fixed allowance. The result is $73,000, the total allowable deduction.

To compute tax:

20 per cent of net income in excess of the deduction ($73,000) but not in excess of 15 per cent of the 1917 capital ($150,000) means that $77,000 is subject to tax at the 20 per cent rate, the tax being	$15,400

25 per cent of net income in excess of 15 per cent ($150,000) and not in excess of 20 per cent ($200,000) of the 1917 capital means that $50,000 is subject to the 25 per cent rate, the tax being	12,500
35 per cent of net income in excess of 20 per cent ($200,000) and not in excess of 25 per cent ($250,000) of the 1917 capital means that $50,000 is subject to the 35 per cent rate, the tax being	17,500
45 per cent of net income in excess of 25 per cent ($250,000) and not in excess of 33 per cent ($330,000) of the 1917 capital means that $80,000 is subject to the 45 per cent rate, the tax being	36,000
60 per cent of the net income in excess of 33 per cent ($330,000) of the 1917 capital means that $70,000 is subject to the 60 per cent rate, the tax being	42,000
Total Tax	$123,400

In a case of this kind a corporation could, if it chose, take advantage of the right of appeal offered in Section 205 of the law.

No. 4

(Corporation not engaged in business in pre-war period; began business June 1, 1917, and desires to file according to its own fiscal year, ending with the last day of May)

The corporation's capital has not varied from its original amount of $100,000. Its net income for the fiscal year beginning June 1, 1917 and ending May 31, 1918, is, of course, not yet known.

To get deduction:

Take 8 per cent of the invested capital. To the amount of $8,000 thus obtained add the fixed allowance of $3,000. The result is $11,000, the total allowable deduction.

To compute tax:

If capital is not increased prior to the end of the fiscal year, the computation can be made, as outlined in preceding examples, after net income for the fiscal year has been ascertained.

If capital is increased, there will, of course, be an increase of the variable part of the allowable deduction.

To fix fiscal year:

Not later than 30 days prior to March 1, 1918 give notice in writing to local Collector of Internal Revenue, stating that return will be filed for fiscal year ending last day of May. (In case of corporation same notice should also be given for income tax.)

It will not, then, be necessary to file return until after May 31, 1918. Return must be filed within 60 days after May 31, 1918.

No. 5

(Increase of capital; also great increase of earning percentage)

The average capital of a corporation for the pre-war period was $500,000. Its average annual net income was $50,000. The pre-war percentage of return on capital was, therefore, 10 per cent. Capital had been increased until it was $1,500,000 at which figure it has remained through 1917. Net income for 1917 is $450,000.

To get deduction:

The full percentage of the pre-war period can not be used. Therefore, take 9 per cent (the maximum) of $1,500,000. To the amount of $135,000 thus obtained add $3,000, the fixed allowance. The result is $138,000, the total allowable deduction.

To compute tax:

20 per cent of net income in excess of the deduction ($138,000) and not in excess of 15 per cent of 1917 capital ($225,000) means that $87,000 is subject to the 20 per cent rate, the tax being	$17,400
25 per cent of net income in excess of 15 per cent (225,000) and not in excess of 20 per cent ($300,000) of 1917 capital means that $75,000 is subject to the 25 per cent rate, the tax being	18,750
35 per cent of net income in excess of 20 per cent ($300,000) and not in excess of 25 per cent ($375,000) of 1917 capital means that $75,000 is subject to the 35 per cent rate, the tax being	26,250
45 per cent of net income in excess of 25 per cent ($375,000), in this case means that $75,000, the remainder of the net income is subject to the 45 per cent rate, the tax being	33,750
Total Tax	$96,150

No. 6

(Increase of capital during the taxable year; the monthly average)

On January 1, 1917, a corporation's capital was $100,000; on June 1, 1917, it was increased to $200,000, and again on October 1, 1917, to $250,000.

There were: 5 months at $100,000.
4 months at $200,000.
3 months at $250,000.

The average invested capital for 1917, for the purpose of the Excess Profits Tax computation would be the average, or $170,833.33.

No. 7

(Without invested capital, or when invested capital is merely nominal)

A professional man has a net income from the practice of his profession for 1917 of $30,000.

The only deduction in such a case would be $6,000.

The tax in such a case would be 8 per cent of net income ($30,000) in excess of the deduction ($6,000) which means that $24,000 would be subject to the 8 per cent rate, the tax being $1,920.

417.—OLD EXCESS PROFITS TAX LAW REPEALED—TAX IS CREDITED.

The Excess Profits Tax provisions of the Act of March 3, 1917,

are repealed by the Excess Profits Tax provisions of the Act of October 3, 1917.

However, any tax paid under the old law will be allowed as a credit under the new law.. If the amount paid under the old law is in excess of the amount due under the new law, a claim for refund may be filed.

418.—MUNITIONS TAX REPEALED AT END OF 1917.

The Munition Manufacturers' Tax, imposed by the Act of September 8, 1916, remains in effect during the year 1917, but no longer. The War Revenue Act provides for its repeal at the end of the year 1917 and at the same time reduces the tax rate applicable to 1917 from 12½ to 10 per cent.

This tax is upon the net profits derived during the year by every person, partnership or corporation manufacturing and disposing of—

(a) Gunpowder and other explosives, except blasting powder and dynamite used for industrial purposes;
(b) Cartridges, loaded and unloaded, caps or primers, except those used for industrial purposes;
(c) projectiles, shells or torpedoes, shrapnel and fuses;
(d) firearms and appendages, and bayonets;
(e) electric motor boats, submarine or submersible vessels;
(f) or any part of the articles mentioned above in sub-paragraphs (b), (c), (d) and (e).

419.—PAYMENT OF TAX.

The Excess Profits Tax is to be paid when the Income Tax is paid. The provisions of the Income Tax law with respect to time of assessment and time and form of payment apply.

CHAPTER XXVII

CAPITAL STOCK TAX

ON CORPORATIONS

420.—AN EXCISE TAX.

The Capital Stock Tax is an excise tax upon the "doing of business" by a corporation. It is what is known as a "Special Tax," and was first imposed by the Act of September 8, 1916. **It is still in effect** and has proved one of the most troublesome of the Federal taxes, owing to the basis of assessment.

421.—FAIR VALUE OF STOCK THE MEASURE.

The measure of the tax is the fair value of capital stock, with surplus and undivided profits to be included in ascertaining such fair value. The statute says that **"fair value"** shall be the basis of assessment but the Treasury Department has at various times by regulation, tried to make the basis **"fair market value."** In this it has not entirely succeeded for the simple reason that the impossibility of giving a "fair market value" to the stock of every corporation engaged in business is so obvious that it does not require explanation. Certainly by arbitrary methods prescribed in general rules the best that can be done in many cases toward determining a "fair market value" is a haphazard attempt at approximation.

422.—THE TAX YEAR.

The period for which this tax is paid is the fiscal year of the Government—from July 1 of one year to June 30 of the following year. This is the case with all of the Special taxes.

423.—WHEN TO MAKE RETURN.

The return, or disclosure of liability, must be filed during the month of July. (The next return due after the publication of this

book is to be filed in July, 1918, for the fiscal year beginning July 1. 1918 and ending June 30, 1919.) If the return is not filed in July, a penalty attaches for delinquency equal to 50 per cent of the amount of the tax. Also the corporation is liable to prosecution for doing business without having paid the Special Excise tax.

A domestic corporation should file return on Form 707; a foreign corporation on Form 708.

424.—TAX RATE.

The tax is imposed at the rate of 50 cents for each **full $1,000** of the fair value of the corporation's issued and outstanding capital stock. (Note the word **"full,"** above.) For example: A corporation's return on Form 707 shows a fair value of capital stock of $675,490, in excess of the exemption. Its tax would be $337.50, computed on $675,000, the amount of $490 (being less than $1,000) being disregarded.

425.—BASIC QUALIFICATIONS.

A corporation, to be subject to this tax, must have been **organized for profit;** it must also **have a capital stock represented by shares.**

426.—BOTH DOMESTIC AND FOREIGN.

Both domestic and foreign corporations are subject to the tax—

(a) **A domestic corporation,** which was engaged in business in the preceding fiscal year (that is, the fiscal year ending June 30, just preceding the July in which return must be filed) and which is continuing in business in the fiscal year beginning in the July when it must file return. (See illustration below.)

(b) **A foreign corporation** engaged in business in the United States, as explained above.

Illustration, referring to (a), above: A corporation not engaged in business in the fiscal year, July 1, 1917—June 30, 1918, would not be subject to the tax even though it should engage in business during the year 1918 subsequent to June 30, 1918. Again, a corporation engaged in business during the whole or a part of the fiscal year, July 1, 1917—June 30,1918, but not continuing in business subsequent to June 30. 1918, would not have to file a return in July, 1918. The corporation would have to be engaged in business for at least a part of the fiscal year, July 1, 1917—June 30,1918, and continue in business subsequent to June 30, 1918 (that is in the fiscal year beginning July 1, 1918) to be liable to file a return in July, 1918, and pay tax for the fiscal year beginning with that month.

427.—EXEMPTION.

A domestic corporation is allowed an exemption of $99,000. The tax is imposed upon fair value of capital stock only in excess of $99,000. (Note: See paragraph "Amount Requiring Return," below.)

A foreign corporation, if it makes a return showing its entire capital is entitled to that proportion of $99,000 which its capital invested in the United States bears to its entire invested capital.

428.—AMOUNT REQUIRING RETURN.

But a return must be filed by a domestic corporation if the fair value of the outstanding capital stock is $75,000 or over. This is the ruling of the Department. In other words, the Department is to be the judge as to whether tax is due, with the margin between $75,000 and $99,000 within which to work. A great many corporations, under this ruling, have to file returns but do not have to pay the tax.

429.—WITH NET INCOME OF $6,000.

Recently the Department instructed its field officers to check over the Income Tax assessment lists and call upon every corporation with an annual net income of $6,000 or more to show cause why it should not have filed Capital Stock Tax returns for past fiscal years, if it did not do so. It is therefore suggested that every corporation whose net income has amounted to $6,000 or more a year, look closely to the value of its outstanding capital stock and, if it find that it should have filed Capital Stock Tax returns, do so at once before demand is made upon it. By voluntary filing, accompanied by a showing that failure to file was due to a misunderstanding of the law, a corporation can avoid the penalties that otherwise would be incurred.

430.—BELOW $75,000, NOT REQUIRED TO FILE.

If a corporation's outstanding capital stock has a fair value of less than $75,000, it is not required to file a return. But it should **be on the safe side,** and look carefully into the question of its liability. There seems to be a conviction in official quarters that this law has not been obeyed, and the penalties of the law will be enforced, should the filing of a return have to be forced by investigation.

A corporation should look closely into its own case, as outlined in this and preceding paragraphs, and make sure of its position.

431.—RETURN BY FOREIGN CORPORATION.

A return is required of every foreign corporation engaged in business in the United States, regardless of the value of its capital, or of the capital invested in the United States.

432.—CORPORATIONS EXEMPT.

All corporations exempt from payment of Income Tax are also exempt from this Capital Stock Tax. (See list in chapter "Corporations Exempt.")

Also **mutual companies** are exempt, since they have not a capital stock **represented by shares,** as the law requires.

433.—VALUE OF CAPITAL STOCK.

The fair average value of the capital stock for the preceding year is the basis of assessment. By this is meant the value for the preceding **fiscal year.** In the case of a return filed in July, 1918, it would be the fair average value for the fiscal year ending June 30, 1918.

434.—TO ASCERTAIN FAIR VALUE.

Three methods for ascertaining the fair value of capital stock for the purposes of this tax will be found in the form for the return (Form 707). One of them should be selected. They are quoted as follows:

When Stock Is Listed on Exchange

(a) **Case I.**—If the stock is listed on any exchange its fair value will be determined by adding the quoted highest bid price for the stock on the last business day of each month during the preceding fiscal year (or, if no bid price was quoted on the last day, in the month on which a bid was quoted), and dividing by 12, the result being the average bid price per share for that year.

Stock Not Listed, But Has Been Sold

(b) Case II.—If the stock is not listed on any exchange, but sales thereof have been actually made, and the price paid for the stock is known to the officer making the return, or can be discovered by him, the average price at which sales were made during the preceding fiscal year shall be the determining factor in ascertaining the fair value per share.

(In the foregoing two cases the actual fair value of the stock is ascertainable from the facts without the necessity of making an estimate.)

When Fair Value Must Be Estimated

(c) **Case III.**—If Case I and Case II can not be applied, viz., the stock is not listed on any exchange, and no actual sales have been made during the preceding fiscal year, or if the price at which sales have been made is not known to the officer making the return, the fair average value of the capital stock shall be estimated, and the surplus and undivided profits for the preceding fiscal year will be taken into consideration as required by the statute, as well as the nature of the business, its earning capacity and average dividends paid, or profits earned, during the preceding five years.

The fair value per share, ascertained or estimated according to one of the methods quoted above, multiplied by the number of shares outstanding will give the fair average value of all outstanding capital stock. If this is $75,000 or more, in the case of a domestic corporation, a return must be filed. Tax is imposed, however, only if the amount exceeds $99,000.

435.—WHEN EARNING CAPACITY GOVERNS.

When Case III, as quoted above, must be used and the fair average value of capital stock must be estimated by the earning capacity during a period of five years, if the corporation has been engaged in business for that length of time, the computation becomes practically a capitalization based upon the percentage of return. The Treasury Department takes the position that the average percentage of profits over the five-year period indicates earning capacity from which may be estimated the fair value of capital stock. For the guidance of its officers the Department has issued a statement to the effect that an examination of the Income Tax returns of a large number of corporations of different classes, whose stock is listed, has shown they earn approximately the following rates in order to make their stock worth par:

Banking:	
(1) West of Mississippi River	**8 per cent**
(2) East " " "	**6 " "**
Mercantile	**10 " "**
Mining	**10 " "**
Industrial	**10 " "**
Oil-producing	**15 " "**
Oil-refining	**10 " "**
Public Utilities:	
Railroads	**8 " "**
Light and Power	**8 " "**
Electric Railway	**8 " "**

436.—SUBSIDIARY CORPORATIONS.

The regulations of the Department are that, where a parent company owns the stock of several subsidiary companies, which is not listed and which has not been sold in the last fiscal year, the fair value of the stock of the subsidiary companies should be ascertained by apportionment of the fair value of the total capital stock of the parent (or holding) company, among the subsidiaries, according to the earnings derived from each subsidiary during the preceding year.

This would not, however, relieve the parent (or holding) company of liability. Both the parent company and the subsidiaries would have to make return and pay the tax, if within the other requirements of the law.

437.—SPECIAL RULINGS.

Many cases that arose under this law during the latter part of 1916 and early part of 1917 required special attention. Correspondence brought out the following special rulings:

A domestic corporation is not allowed deduction for any amount of capital invested in a foreign country.

Any surplus or undivided profits of a corporation invested in bonds or other securities having no connection with the business of the corporation will be taken into consideration if the method outlined in Case III, explained above, is used. Any such investment should, however, be stated in the return, and special attention should be called to it.

Capital stock that has once been issued by a corporation is regarded as "outstanding," even though it is afterwards acquired by the corporation and carried as "treasury stock."

The surplus and undivided profits, if any, when stated in a return, should be those shown by the books for the preceding fiscal year ending June 30. If, however, a corporation prefers, it may use the figures shown by the books for the last preceding calendar year ending December 31.

If the average profits per share during the preceding five years indicate an earning capacity in excess of book value, the fair value of the capital stock may be based upon a reasonable return on capital invested, the hazards of the business or the market price of stock of similar corporations being taken into consideration.

If the book value results from an over-estimation of capital assets, the fact should be set forth in a statement attached to the return, so that it may be considered in the assessment.

A corporation, in business during any part of the preceding fiscal year but not in business in July, 1918, is not required to file return in

July and pay tax for the ensuing fiscal year. But should it resume business at any time during the fiscal year,, beginnig July 1, 1918, it would have to file return in the month in which it resumes business, and pay tax computed according to the remainder of the fiscal year, counting in full the month in which business is resumed.

A corporation in the hands of a receiver at the opening of the fiscal year is not required to file return. The same relief from liability applies to a corporation in the hands of a receiver during all of the preceding fiscal year.

If the combined stocks of two banks (in this case, a bank and a trust company) have a definite market value, but each stock has not a separate market value, the combined market value may be apportioned between the two corporations on the basis of the capital stock, surplus and undivided profits of each.

Corporations that have no regular earnings, such as those organized to develop and sell timber lands, mining properties, and other real property, and corporations that have had no profits during the past five years, can not base value of capital stock upon earning capacity. They are allowed to substitute an estimate based upon book value but should attach to their returns an explanatory statement.

438.—WHAT DOES "ENGAGED IN BUSINESS" MEAN?

A corporation is not liable to the Capital Stock Tax **unless it is "engaged in business,"** within the meaning of the term according to the law.

The question therefore becomes one of great importance. When is a corporation "engaged in business?"

The Treasury Department has not given a definite answer. It has ruled in individual cases, but has not laid down a general rule, or issued a general interpretation, that can be followed.

Each corporation must, therefore, answer the question for itself, with such advice and information as may be available.

This Capital Stock Tax, measured by fair value of capital stock, is an excise tax upon the doing of business; so also was the Corporation Excise Tax imposed by the Act of August 5., 1909, even though that earlier tax was measured by net income. In their essentials the two taxes are similar. Hence, cases that reached the Federal Courts under the Act of August 5, 1909 have a direct bearing upon the administration of the Capital Stock Tax.

Each corporation should look into this question, for it is likely that some corporations that have been paying the Capital Stock Tax may find that they are not liable to it; while others that have not been paying it may find that they are liable.

The reader is referred to the reasoning of the Supreme Court of the United States in the case of Baumbach, Collector, v. Sargent Land Co., et al. The case is to be found in (219 Fed. 31.) Then it went before the Supreme Court on writ of certiorari and Mr. Justice Day delivered the opinion of the Court. With respect to the question of "doing business" within the meaning of the tax Act, the Court said:

> Were the respondents carrying on business, within the meaning of the Corporation Tax Act? This question was dealt with by this court in the first of the Corporation Tax Cases, Flint v. Stone Tracy Company, 220 U. S. 107. As the tax was there held to be assessed upon the privilege of doing business in a coroprate capacity, it became necessary to inquire what it was to do business, and this court adopted with approval the definition, judicially approved in other cases, which included within the comprehensive term "business" "that which occupies the time, attention and labor of men for the purpose of a livelihood or profit."
>
> In that case a number of realty and mining companies were dealt with, and the Park Realty Company, organized to deal in real estate, and engaged at the time in the management and leasing of a certain hotel, was held to be engaged in business. It was also held that the Clark Iron Company, organized under the laws of Minnesota, and owning and leasing ore lands for the purpose of carrying on mining operations, and receiving a royalty depending upon the quantity of ore mined, was engaged in business.
>
> At the same time, and decided with the main corporation tax case, this court held, in the case of Zonne v. Minneapolis Syndicate, 220 U. S. 187, that a corporation which owned a piece of real estate which had been leased for 130 years, at an annual rental of $61,000, and which had amended its articles of incorporation so as to limit its purposes to holding the title to the property mentioned, and, for the convenience of its stockholders, to receiving and distributing from time to time the rentals that accrued under the lease and the proceeds of any disposition of the land, was not engaged in doing business within the meaning of the act, by reason of the fact that the corporation had practically gone out of business and had disqualified itself from any activity in respect thereto.
>
> The act next came before this court in the case of McCoach, Collector, v. Minehill Railway Company, 228, U. S. 295, in which it was held, distinguishing the case of the Park Realty Company, supra, and applying the case of Zonne v. Minneapolis Syndicate, supra, to the facts before the court, that a corporation which had leased all its property to another, and was doing only what was necessary to receive and distribute the income therefrom among stockholders, was not doing business within the meaning of the act.
>
> In United States v. Emery, 237 U. S. 28, this court held that a corporation which merely kept up its organization, distributing rent received from a single lessee, was not doing business within the meaning of the act.
>
> It is evident, from what this court has said in dealing with the former cases, that the decision in each instance must depend upon the particular facts before the court. The fair test to be derived from a consideration of all of them is between a corporation which has reduced its activities to the owning and holding of property and the distribution of its avails and doing only the acts necessary to continue

that status, and one which is still active and is maintaining its organization for the purpose of continued efforts in the pursuit of profit and gain and such activities as are essential to those purposes.

From the facts clearly established in these cases, we think these corporations were doing business, within the meaning of the act. They were organized for the purposes stated, and their activities included something more than the mere holding of property and the distribution of the receipts thereof. As was found by the District Court, the evidence shows that these three companies sold, during each of the years named, quantities of real estate, and the same were not small. They sold stumpage from some of the properties which had been burned over, leased certain properties in the village of Hibbing, and granted leases to squatters. One of the companies made explorations and incurred expenses in the matter of test pits. They employed another company to see that the mining operations were properly carried on, and that the lessees lived up to the engagements of their contracts. "All these things indicate," said the learned district judge, "the doing of and engaging in business. It [the corporatinn] was doing the business of handling a large property, selling lots, and seeing that the lessees lived up to their contracts. If that is not engaging in business, I do not know what is." We agree that it certainly was doing business, and, as the Corporation Tax Act requires no particular amount of business in order to bring a company within its terms, we think these activities brought the corporations in question within that line of decisions in this court which have held such corporations were doing business in a corporate capacity within the meaning of the law.

439.—FAILURE TO RECEIVE FORM.

Failure to receive a form on which to make this return can not be offered as an excuse by a corporation for not filing a return. This question has come up many times and the Government has insisted that the corporation should have obtained a form without awaiting the receipt of one by mail. In all such cases the penalty has been imposed.

440.—PAYMENT OF TAX.

This tax may be paid when the return is filed in July; or later, when a notice of assessment is received. If payment is deferred until receipt of notice, it must be made within ten days of the date of the notice.

441.—NO REFUND FOR PART YEAR.

If a corporation should in July, 1918, pay tax for the entire fiscal year beginning July 1, 1918, and should during that year go out of business, it could not obtain a refund of any part of the amount paid.

CHAPTER XXVIII

ESTATE TAX

442.—TAX UPON TRANSFER.

The Federal Estate Tax is imposed upon the transfer of the net estate. The tax is graduated, according to the amount of the net estate. It is a tax which must be considered as having no relation to the State Inheritance Tax. Confusion regarding the separation of the two taxes—one a Federal tax and the other a State tax—has caused a great deal of trouble.

443.—RATES VARY ACCORDING TO DATE OF DEATH.

The Estate Tax was first imposed by the Act of September 8, 1916 upon the taxable estates of decedents dying after that date. Then the rates were increased by the Act of March 3, 1917, with respect to the estates of decedents dying after that date. And, again, the rates were increased by the Act of October 3, 1917, with respect to the estates of decedents dying after that date. The result is, therefore, that three different scales of rates are now in effect, the scale to be applied depending on the date of the decedent's death. These three scales are shown by the following table:

Rates of Taxation Upon Net Estates

	Sept. 9, 1916 to Mar. 2, 1917, inclusive. Per cent.	Mar. 3, 1917 to Oct. 3, 1917, inclusive. Per cent.	On and after Oct. 4, 1917. Per cent.
Net estate not exceeding $50,000	1	1½	2
Net estate $50,000 to $150,000	2	3	4
Net estate $150,000 to $250,000	4	4½	6
Net estate $250,000 to $450,000	4	6	8
Net estate $450,000 to $1,000,000	5	7½	10
Net estate $1,000,000 to $2,000,000	6	9	12
Net estate $2000,000 to $3,000,000	7	10½	14
Net estate $3,000,000 to $4,000,000	8	12	16
Net estate $4,000,000 to $5,000,000	9	13½	18
Net estate $5,000,000 to $8,000,000	10	15	20
Net estate $8,000,000 to $10,000,000	10	15	22
Net estate exceeding $10,000,000	10	15	25

444.—WHEN DEATH DUE TO WAR.

Other than an increase in rates the only change made by the Act of October 3, 1917 is an exemption from the last increase in the case of a transfer of the estate of any person dying while in the military or naval service during the war or from injury received or disease contracted in the service within one year after the termination of the war. This exemption does not apply, however, to the first two tax scales shown in the table above.

445.—EXEMPTION.

An exemption of $50,000 is allowed in the case of estates of residents of the United States; but no exemption in the case of estates of non-residents. A citizen whose residence is abroad is a non-resident

446.—TERRITORY COVERED.

Residents of the Philippines or Porto Rico are "non-residents." The term "United States" means only the continental States and Hawaii, Alaska and the District of Columbia.

447.—GROSS ESTATE.

The gross estate includes the value **at the time of death** of all property, real or personal, tangible or intangible, wherever situated:

(a) To the extent of the decedent's interest at the time of death and which after his death is subject to payment of charges against his estate, expenses of administration and distribution.

(b) Also to the extent of any interest of which the decedent has made a transfer at any time, or with respect to which he has created a trust, **in contemplation of or intended to take effect at or after his death,** except a bona fide sale for money or the equivalent of money. **Any transfer** of a material part of his property in the nature of final disposition, made **within two years prior to death without such a consideration,** will be regarded, unless the contrary can be shown, **as having been made in contemplation of death,** and, therefore, the value of the property transferred would be a part of the gross estate.

(c) To the extent of the interest therein held jointly or as tenants in the entirety by the decedent and any other person, or deposited in banks or other institutions in their joint names and payable to either or the survivor, except such part as may be shown to have originally belonged to such other person and never to have belonged to the decedent.

448.—MISCELLANEOUS ITEMS.

The value of all "tax-free" bonds—those of the United States and all others—is a part of the gross estate.

Dividends declared prior to death are to be included, whether paid before or after death.

Bond interest accrued up to the date of death is to be included.

Interest on mortgage notes and certificates of deposit, dividends (if fixed and certain) on preferred stock, and all fixed and certain earnings, must be included to the amount accrued to the date of death.

The value of loans evidenced by promissory notes is to be included, even though the will provides for cancellation of the notes.

Bonds and stock of corporations are to be included. However, bonds of a domestic corporation owned by a non-resident and kept in another country are not to be included.

Community property, held in partnership by husband and wife, is to be included only to the amount of one-half of its value in the gross estate of either husband or wife. But if the wife's interest is merely the common law right of dower the whole value is to be included in the deceased husband's gross estate. This rule also applies where the husband's interest is equivalent merely to the curtesy right.

Insurance paid directly to the beneficiary named in the policy is not to be included.

Income of the estate and appreciation of value of property after death are not to be included.

449.—NET ESTATE.

The net estate is to be ascertained by deducting from the value of the gross estate—

(a) **Of a resident—**

(1) Funeral expenses, administration expenses, claims against estate, unpaid mortgages, losses from casualty or theft not covered by insurance, support of decedent's dependents during settlement, and such other charges against the estate as are allowed by the laws of the jurisdiction.

(2) And an exemption of $50,000.

(b) **Of a non-resident—**

By deducting from that part of his gross estate situated in the United States deductions computed in the proportion

that the value of the estate in the United States bears to the value of the entire gross estate. These deductions are allowed, however, only if the return shows the entire gross estate.

450.—STATE INHERITANCE TAX NOT DEDUCTIBLE.

The amount paid the State as Inheritance Tax cannot be deducted in ascertaining net estate. Neither can the Federal Estate tax, since the latter does not attach until after net estate has been determined.

451.—EXECUTOR MUST GIVE NOTICE.

Within 30 days after qualifying an executor must give notice to the Collector of Internal Revenue of the district in which the decedent lived. This notice should be on Form 704, which can be obtained from the Collector.

452.—RETURN AND TAX DUE.

The return must be filed on Form 706, and tax paid **within one year of the decedent's death.**

A return must be made for every estate of a resident with a gross value of $60,000, or with a net value, as hereinbefore explained, in excess of the exemption of $50,000. Return is required for the estate of a non-resident, whatever the value.

453.—TENTATIVE RETURN.

If it is impossible to file a complete return within one year, the Collector can grant an extension of time upon the filing of a tentative return.

454.—AGENT MUST FILE.

The person in charge of the estate of a non-resident in the United States is required to file the return.

455.—BENEFICIARY MUST FILE.

If there are no executors or administrators, or if any part of an estate does not pass through executors or administrators, the beneficiaries must file the estate return, either in whole or in part.

456.—DISCOUNT FOR ADVANCE PAYMENT.

Although the tax is not required to be paid until a year after the decedent's death, a discount at the rate of 5 per cent per annum is allowed for earlier payment, the discount to be computed from the date of payment to the due date, which is one year after death. This discount is based upon a year of 365 days. To arrive at it follow this formula:

Tax multiplied by 5 per cent, multiplied by the exact number of days from date of payment to due date, divided by 365 equals discount.

[Additional instructions relative to the Estate Tax will be given in the monthly supplement to this book.]

CHAPTER XXIX

STAMP TAXES

DOCUMENTS, INSTRUMENTS, TICKETS AND PLAYING CARDS.

Title VIII of the War Revenue Act of October 3, 1917 imposes a number of stamp taxes upon documents and instruments in writing and upon steamship tickets, and increases the tax on playing cards. It makes these stamp taxes **effective December 1, 1917.** On and after that date every document or instrument and every ticket covered by the law must be stamped according to the requirements of the act. Severe penalties are provided for failure to obey the law.

Below appears the documentary tax schedule, referred to in the statute as **"Schedule A—Stamp Taxes."** After the taxpayer has noted the rates given in the schedule he should look under the proper headings for the special instructions relative to certain documents based upon experience in administering the documentary stamp provisions of the Emergency Revenue Act of October 22, 1914.

Schedule A of the War Revenue Act follows:

Schedule A—Stamp Taxes.

457.—BONDS OF INDEBTEDNESS.

Bonds, debentures, or certificates of indebtedness issued on and after December 1, 1917 by any person, corporation, partnership or association, on each $100 of face value or fraction thereof.......$0.05

When such bonds, debentures or certificates are renewed, another tax of 5 cents on the same basis is imposed.

458.—BONDS—INDEMNITY AND SURETY.

Indemnity bonds and bonds for performance of contract or duties of office or accounting for funds, and all other bonds except those required in legal proceedings.

Rate of tax:

If premium is charged, then for each dollar of premium or fraction thereof....... .01

If premium is not charged, flat rate for each bond of .... .50

459.—CAPITAL STOCK—ISSUE.

On original issue of certificates, whether on organization or reorganization, on each $100 of face value or fraction thereof .... .05

When certificates are issued without face, or par, value and actual value of each share does not exceed $100, flat rate for each share issued of .... .05

When certificates are issued without face, or par, value and actual value of each share does exceed $100, rate is for each $100 of actual value of each share or fraction thereof .... .05

Stamps denoting payment of the tax should be affixed to the stock books and not to the certificates.

460.—CAPITAL STOCK—SALE OR TRANSFER.

On all sales, agreements to sell, memoranda of sales, or deliveries of, or transfers of legal title to shares of stock (whether shown on books of company or effected by assignment in blank or evidenced by memorandum), on each $100 of face value or fraction thereof .... .02

When shares have been issued without face, or par, value and the actual value of each share does not exceed $100, tax rate is for each share .... .02

When shares have been issued without face, or par, value and the actual value of each share does exceed $100, tax rate is for each $100 of the actual value or fraction thereof, for each share .... .02

When evidence of transfer is shown by books of company, stamp should be affixed to books; when change of ownership is by transfer of certificate, stamp should be affixed to certificate; when transfer is evidenced by agreement to sell, or memorandum, or by delivery of certificate assigned in blank, stamp must be affixed to agreement or memorandum.

Any person, or any broker, who makes a sale or delivers stock, or delivers memorandum of sale of stock, without payment of tax is liable to a fine of $1,000, or six months in prison, or both.

461.—SALES OF PRODUCE ON EXCHANGE.

On each sale, or agreement to sell (including the so-called transferred or scratch sales) any products or merchandise on an exchange, or board of trade or similar place, for future delivery, for each $100 in value of the merchandise .... .02

And for each additional $100 in value or fractional part thereof in excess of $100 .... .02

Every sale, or agreement of sale, or agreement to sell must be accompanied by a bill or memorandum or other evidence of the sale or agreement, to which must be affixed the necessary stamps.

Penalty for violation is fine not exceeding $1,000, or six months in prison, or both.

462.—PROMISSORY NOTES.

On every promissory note, except a bank note issued for circulation, for sum not exceeding $100 .... .02

For each additional $100 or fraction thereof .... .02

Each renewal is subject to a new tax at same rate.

Under this heading also comes any draft or check payable otherwise than at sight or on demand.

463.—DEEDS—CONVEYANCES.

On every deed, instrument, or writing, by which realty is granted, assigned, transferred or otherwise conveyed, when, exclusive of the value of any lien or encumbrance remaining on the property at the time of sale, the consideration or value of the interest or property conveyed exceeds $100 but does not exceed $500 .... .50

For additional $500 or fraction thereof .... .50

No instrument given to secure a debt is taxable under this provision.

464.—CUSTOM HOUSE ENTRIES.

On each entry of any goods at a custom house, for either consumption or warehousing——

Not exceeding $100 in value .25
Exceeding $100 and not exceeding $500 in value .50
Exceeding $500 in value 1.00

465.—ENTRIES FOR WITHDRAWAL.

On each entry for the withdrawal of any goods from a customs bonded warehouse .50

466.—STEAMSHIP TICKETS.

On each passage ticket, one way or round trip, for each passenger, sold or issued in the United States for passage by a vessel to a port or place not in the United States, Canada or Mexico——

Ticket costing more than $10 but not more than $30 1.00
Ticket costing more than $30 but not more than $60 3.00
Ticket costing more than $60 5.00
A ticket that does not cost more than $10 is exempt.

467.—PROXIES.

On each proxy for voting at any election for officers, or meeting for the transaction of business of a corporation, except religious, educational, charitable, fraternal and literary societies and public cemeteries .10

468.—POWER OF ATTORNEY.

On each power of attorney granting authority when such authority is not otherwise vested in the person to whom the power of attorney is given .25

469.—PLAYING CARDS.

On each pack of playing cards, of not more than 54 cards each, manufactured or imported, and sold or removed for consumption or sale after the passage of the act, an increase of 5 cents, making the tax per pack .07

470.—PARCEL-POST PACKAGES.

On every parcel or package sent by parcel post from one point in the United States to another, when postage amounts to 25 cents or more, the tax is for each 25 cents in postage or fraction thereof .01

When the postage is less than 25 cents there is no tax.

When the postage is 25 cents or more, the parcel will not be forwarded until the tax is paid by affixing the proper stamp.

The consignor must pay the tax.

471.—EXEMPTION OF CERTAIN BONDS.

The law specifically exempts from tax any bond, note or other instrument, issued by the United States, or by any foreign government, or by any State, Territory or the District of Columbia, or by any municipality or other governmental unit.

It also exempts **both the stocks and bonds** issued by cooperative building and loan associations which are organized and operated exclusively for the benefit of their members and make loans only to their shareholders.

And it likewise exempts stocks and bonds issued by **mutual irrigating companies** and **mutual ditch companies.**

472.—WHO MUST PAY TAX.

In the case of taxable documents the Government will look to the maker or signer for the tax. Liability attaches primarily to the person or the corporation from whom the document issues. Such was the general rule followed in the administration of the documentary tax schedule of the Emergency Revenue Act of October 22, 1914.

A corporation issuing bonds of indebtedness must affix tax stamps to the bonds.

The same is true with respect to indemnity and surety bonds.

A corporation issuing its capital stock must affix to its stock books stamps denoting payment of tax.

In the case of a sale or transfer of stock, the person making the sale, or the broker acting in the transaction, must see that the tax is paid. The broker cannot effect the transfer or sale without making sure that stamps have been affixed to the memorandum of sale, or of transfer, or to the certificate or books, as directed by law, and explained in "Schedule A—Stamp Taxes," above.

In the case of a sale, or agreement to sell, or agreement of sale, of products on an exchange, or similar institution, such sale or agreement calling **for future delivery,** tax liability attaches to the seller. The seller is required by law to make and deliver to the buyer a bill, or memorandum or other evidence of the transaction, and must affix to such bill or memorandum stamps in proper amount.

A promissory note must be stamped by the person who makes it. When it is renewed, it must be stamped again at the full rate, and again liability attaches to its maker.

A deed or conveyance of realty must be stamped by the grantor. The Treasury Department held under the law of 1914 that the grantor would be regarded as the responsible party, under the penalties of the law, and the language of the present statute would indicate that the same course must be followed.

With respect to custom house entries the tax must be paid by the person who makes the entry.

Tickets for travel by vessel must be stamped before they can be presented for passage. The Government collects from the transportation company (the owner and operator of the vessels) but the company will add the amount of the tax to the price of the ticket in each case and require the passenger to pay it.

A proxy must be stamped by the person giving it; a power of attorney also by the grantor.

The tax on shipment of parcels and packages by parcel post must be paid by the consignor.

473.—SECONDARY LIABILITY.

Primary liability for tax has been referred to above but in nearly every case there is what might be termed a secondary liability. The law imposes penalty not only upon "whoever makes, signs and issues" any document or instrument or paper subject to tax without the tax being paid, but also upon "whoever accepts" such document or paper. This does not mean that the person primarily liable can leave payment of tax to another. It does mean that the Government can collect the tax wherever it finds, unstamped, a paper, document or instrument that should have been stamped; and it can assert the penalty as circumstances warrant.

The person receiving a deed, or bond, or certificate of stock, or promissory note, or proxy or power of attorney, should, therefore, see that the law with respect to payment of the stamp tax has been complied with; otherwise, such person will become liable under the law.

474.—WHERE TO BUY STAMPS.

The adhesive stamps with which these documentary taxes are to be paid can be purchased from the office of the Collector of Internal Revenue, and at postoffices and United States depositary banks. It is likely also that a great many other banks will keep considerable stocks for the convenience of their depositors and customers, and that County Clerks and County Recorders will have them on hand.

475.—WITH REFERENCE TO CONVEYANCES.

The law provides that its language shall not be so construed as to impose a tax upon any instrument or writing given to secure a debt.

It also makes the measure of the tax upon a taxable instrument of conveyance the consideration or value of the interest or property conveyed in excess of any lien or encumbrance on the property at the time of sale. If there is no consideration capable of being expressed in money terms, there is no tax.

It follows, therefore, according to the Department's rulings under the stamp tax acts of June 13, 1898 and October 22, 1914, that—

A deed of trust is not subject to tax, no matter in what form it is executed.

Escrow deeds are not subject to tax until final delivery of them.

A mere contract for a deed, used in selling real estate, is not taxable.

When a partition deed merely defines boundary lines or shows each tenant in common's interest, there is no tax due.

A deed of gift, without valuable consideration, is not subject to tax.

A conveyance of realty to trustees or other persons without valuable consideration is not taxable.

A quitclaim deed is taxable according to the value of the property interest conveyed.

476.—WITH REFERENCE TO STOCKS AND BONDS.

A transfer of stock to a broker in order that he may sell it, or a transfer from a broker to a customer, is not subject to tax, but the law requires that each such delivery or transfer be accompanied by a certificate reciting the facts.

If a stockholder surrenders a certificate of stock and requests the issuance of several certificates, of smaller denomination but aggregating the same stock interest, there being no change of either interest or ownership, the new certificates issued by the corporation have been held not subject to tax.

Certificates of stock of a foreign corporation when sold or delivered in the United States are liable to the same tax as the stock of a domestic corporation.

A bond is "issued," according to a ruling made under the law of 1898, "when there accrues to the corporation a benefit or consideration for issuing the same." Then it becomes subject to tax. As bonds issued on and after December 1, 1917 are subject to tax, it would seem proper to follow the old ruling, there being no later one to the contrary.

477.—BONDS REQUIRED IN LEGAL PROCEEDINGS.

Bonds required in legal proceedings are not subject to tax under the present law. The same exemption was in the law of 1914. The Department then advised as follows as to the line of demarcation between bonds which are required in legal proceedings and bonds which are taxable:

"Bonds given by court officers under direction or authority of the

court to give proper effect to court proceedings and practically a part of the record of a suit or proceeding in court are not taxable. Bonds given in cases of appeal are not taxable. Bonds given by executors, administrators, guardians, and receivers appointed by the court are bonds required in legal proceedings and are not taxable."

478.—USE OF STOCK AS COLLATERAL NOT SUBECT TO TAX.

A deposit of certificates of stock as collateral security for a loan does not call for payment of the tax imposed upon transfers of stock. This use of stock certificates is specifically exempted in the law.

CHAPTER XXX

TAX ON INSURANCE POLICIES

The War Revenue Act of October 3, 1917 imposes a new tax upon policies of insurance.

This tax became **effective November 1, 1917** and any policy issued on or after that date is subject to it.

With respect to the various lines of insurance the tax rates follow.

479.—LIFE INSURANCE.

The tax is at the rate of **8 cents on each $100** or fractional part thereof of the amount for which any life is insured. In this case the basis of tax, it will be noted, is the amount of the insurance.

The one exception is that on a policy for life insurance only, issued on the industrial or weekly payment plan of insurance, and with the amount of insurance not in excess of $500, the tax rate is **40 per cent of the first weekly premium.**

480.—MARINE, INLAND, FIRE INSURANCE.

The tax is at the rate of **one cent on each dollar** or fraction thereof of the premium charged on each policy by which insurance is made or renewed upon property of any description, including rents and profits. Here the basis of tax is the premium.

481.—CASUALTY INSURANCE.

The tax is at the rate of **one cent on each dollar** or fraction thereof of the premium charged on each policy or obligation of the nature of indemnity for loss, damage or liability, except bonds subject to the documentary stamp tax under Schedule A (to be found described in another chapter). This tax is broad in its application and affects any person, corporation, partnership or association engaged in the writing of any kind of insurance except life, marine, inland and fire insurance, which are subject to tax as noted in preceding paragraphs.

It also is imposed upon all policies or obligations issued, executed or renewed on or after November 1, 1917.

482.—REINSURANCE EXEMPT.

Policies of reinsurance are exempt from tax under all the provisions of the law.

483.—INSURERS EXEMPT.

The law also provides that any corporation or association which is exempt under the provisions of the Income Tax law of September 8, 1916 can write policies of insurance without having such policies subject to tax. A list of these corporations and associations can be found in the chapter headed "CORPORATIONS EXEMPT."

483a.—COLLECTION OF THE TAX.

The tax is upon the issuance of the policies and must be paid by those who issue the policies.

Within the first 15 days of each month any person, corporation, partnership, or association issuing policies subject to tax, must make a return under oath, in duplicate, and pay the tax shown to be due to the Collector of Internal Revenue of the district in which the principal office or place of business of the insurer is located. This return, to be filed not later than the fifteenth of the month, is to cover tax liability for the preceding month.

CHAPTER XXXI

TAX ON TRANSPORTATION, ETC.

TAX ON TRANSPORTATION OF GOODS BY FREIGHT AND EXPRESS, ALSO OF PASSENGERS, ALSO OF OIL BY PIPE LINE, ALSO ON SEATS, BERTHS, STATEROOMS, ETC., AND ON TELEGRAPH AND TELEPHONE MESSAGES.

All the taxes referred to in this chapter, and imposed by Title V of the War Revenue Act of October 3, 1917, are new with the exception that under the Emergency Revenue Act of October 22, 1914, certain items of the schedule were covered either by assessment or by levy of stamp tax. However, the collection of taxes under the previous act having been terminated, all the taxes covered by Title V of the present act can be regarded as new taxes.

The effective date of all these taxes was fixed by the statute as November 1, 1917.

484.—TAX ON FREIGHT SHIPMENT.

The tax on the shipment of property by freight is **3 per cent of the amount paid for transportation** by rail or water or by any form of mechanical motor power **when such motor transportation is in competition with transportation by rail or water.**

The tax is imposed only upon transportation of freight **consigned from one point in the United States to another.**

485.—TAX ON EXPRESS SHIPMENT.

The tax on the shipment of property by express is first restricted to transportation by persons, or partnerships or corporations engaged in the express business **over regular routes between fixed terminals.**

The above condition being present, the tax is imposed at the rate of **one cent for each 20 cents, or fraction thereof,** of the amount charged for the transportation.

And, again, the shipment must be **from one point in the United States to another** to be taxable.

486.—TAX ON PASSENGER TRANSPORTATION.

This tax, with certain exceptions noted below, is imposed at the rate of **8 per cent of the amount paid for the transportation.**

The tax may be considered under the following general divisions with respect to means of travel—

(a) **By rail** from one point in the United States to another or to any point in Canada or Mexico, if the ticket is sold or issued in the United States.

(b) **By water** from one point in the United States to another or to any point in Canada or Mexico, if the ticket is sold or issued in the United States. In addition to this tax on transportation by water, there is provided in Title VIII a stamp tax on tickets for passage by vessel to any port or place not in the United States, Canada or Mexico.

(c) **By motor** on a regular established line when in competition with rail or water, and from one point in the United States to another or to any point in Canada or Mexico, if the ticket is sold or issued in the United States.

487.—TAX ON SEATS, BERTHS, STATEROOMS.

The tax on seats, berths and staterooms in parlor cars, sleeping cars, or on vessels, is imposed at the rate of **10 per cent of the amount paid for such accomodation.**

488.—TAX ON TELEGRAPH AND TELEPHONE. MESSAGES.

The tax upon telegraph, telephone and radio messages or conversations is at the **flat rate of 5 cents for each message or conversation** originating within the United States and for which a charge of 15 cents or more is made. This means that a message or conversation costing less than 15 cents is not subject to tax. The law also provides that the tax shall be collected only once upon any message or conversation in a case where transmission requires the use of the lines or stations of more than one concern.

489.—TAX ON PIPE LINE TRANSPORTATION.

The tax upon the transportation of oil by pipe line is at the rate of 5 per cent of the amount paid for such transportation.

490.—EXCEPTIONS TO GENERAL TAX RULES REGARDING PASSENGER TRANSPORTATION.

In the case of passenger transportation, an amount paid for a commutation or season ticket for trips less than 30 miles, or for transportation when the fare does not exceed 35 cents, is not subject to tax.

If a mileage book, used for transportation or accomodation, was purchased before the tax became effective—that is, was purchased prior to November 1, 1917—the conductor or other agent of the transportation company must collect the tax when the book is presented on or after November 1, 1917.

If the passenger pays cash fare, instead of purchasing a ticket, the conductor or other agent of the transportation company must collect the tax when the fare is paid.

If a regular ticket—that is, other than a mileage book—was bought and partially used before November 1, 1917, it is **not** subject to tax when the remainder of it is used on or after November 1, 1917.

If a regular ticket—that is, other than a mileage book—was bought before November 1, 1917, but was not used at all, **it is** subject to tax when presented for passage on or after November 1, 1917.

491.—EXCEPTIONS TO GENERAL TAX RULES REGARDING FREIGHT OR EXPRESS SHIPMENTS.

In a case where the carrier owns the commodity transported, and for that reason or some other, does not receive payment for the transportation, the tax is to be collected from the carrier at a rate equivalent to the tax that would be imposed were payment received.

However, this clause does not mean that a carrier must pay tax upon the transportation of a commodity which is necessary for its use in the carrying business, and is intended to be or has been so used. And neither does it mean that one carrier, which constitutes a part of a railroad system, must pay tax upon the transportation of material for another carrier, which is also a part of the same system.

492.—PAYMENT FOR SERVICE TO GOVERNMENT OR STATE NOT TAXABLE.

No tax is required to be paid upon any service rendered by a carrier to the United States, or to any State, Territory, or the District of

Columbia. This includes the service rendered in the transportation of both freight and passengers, or express matter. The exemption also covers payment for any transportation of oil by pipe line, and for any telegraph, telephone or radio service rendered the Federal, or a State or Territorial, or the District of Columbia government.

493.—WHO PAYS THE TAX.

The tax must be paid by the person, corporation, partnership or association paying for the service rendered. This rule of tax liability is imposed with respect to any service rendered in the transportation of freight, express matter, and passengers, or of oil by pipe line, or in connection with the use of seats, berths and staterooms, or the means of communication afforded by telegraph, telephone and radio facilities.

The only exceptions to the rule are those referred to in the first paragraph under the heading **"Exceptions to General Tax Rules Regarding Freight or Express Shipments"** and that exempting from tax the payment for service rendered the Federal Government, etc. In the case of the first of these exceptions the carrier must bear the tax.

494.—COLLECTION OF THE TAX.

Those who receive payment for the services rendered are made liable for the collection of the tax. Any person, corporation, partnership, or association, receiving any such payment, must file monthly return, under oath, in duplicate, with the Collector of Internal Revenue of the district in which the principal office or place of business of the public utility is located. The return must be made on an official form to be obtained from the office of the Collector.

495.—A DIFFERENCE TO NOTE.

While the law states that in the case of shipments by freight or express the tax is to be collected only upon payments for transportation from one point in the United States to another,

in the case of transportation of passengers it makes the tax applicable not only to travel from one point in the United States to another but also to any point in Canada or Mexico, so long as the ticket is sold or issued in the United States.

This distinction should be borne in mind.

CHAPTER XXXII

TAX ON ADMISSIONS AND DUES

The new Federal tax on admissions to places of amusement, recreation, etc., and on the dues or membership fees (including initiation fees) paid to any social, athletic or sporting club was made **effective November 1, 1917.**

496.—EXEMPTIONS.

The admission tax is not imposed if the charge for admission to a place is not more than 5 cents, or (in the case of outdoor general amusement parks or shows or rides within such parks) is not more than 10 cents. The exemption also covers all admissions where the proceeds go exclusively to religious, educational, or charitable institutions, societies or organizations, or all admissions to agricultural fairs, when no part of the profits from such admissions inures to the benefit of any individual member.

There are also exempted from subjection to tax all dues or fees paid to a fraternal beneficiary society, order, or association, operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and providing for the payment of life, sick, accident, or other benefits to the members of such society, order or association or their dependents.

497.—RATES OF TAX ON ADMISSIONS.

With the exceptions noted above, the rates of tax on admissions are as follows:

1.—One cent for each 10 cents or fraction thereof of the amount paid for admission. The tax must also be collected in the case of admission by season ticket or subscription. The person paying for the admission must pay the tax; the law says so.

2.—One cent on admission of children under twelve years of age, whatever the amount of the charge for admission, when admission is charged.

3.—One cent for each 10 cents or fraction thereof of the regular admission charge (collected from others) in the case of all persons admitted free except bona fide employees, municipal officers on official business and children under twelve years of age. This means that if a person, who is not an employee, an officer or a child under twelve, is admitted free, he must nevertheless pay the tax that he would have been required to pay had the proprietor of the place charged him the regular admission price. The law places the tax liability upon the person admitted.

4.—One cent for each 10 cents or fraction thereof paid for admission to any public performance for profit at any cabaret or other similar entertainment, where the charge for admission is either wholly or in part covered by the price paid for refreshment, service, or merchandise. This reaches the form of entertainment—cafe or other form—to which there is no entrance charge, or to which there is a mere nominal entrance charge, the principal expenditure of the patron, in return for the entertainment given, being made within the place in the purchase of refreshments. The patron of this form of entertainment must bear the tax.

5.—In the case of a person who has the permanent use of a box or seat, or a lease for the use of such box or seat, in any opera house or place of amusement, a tax is to be collected equivalent to 10 per cent of the amount for which a similar box or seat is sold for the performance or exhibition at which the box or seat is used, or is reserved by or for the lessee or holder. And the lessee or holder must pay the tax.

498.—RATE OF TAX ON DUES.

With the exception with reference to fraternal and certain other societies, hereinbefore mentioned, the rate of tax on club dues and fees is as follows:

Ten per cent of the entire amount of dues and fees paid (including initiation fees), when the total of such payments made by an individual member is in excess of $12 a year. If the total does not amount to $12 a year, there is no tax.

The person who pays the dues and fees—the club member—must also pay the tax.

499.—COLLECTION OF THE TAXES.

The duty of collecting the tax on admissions is placed upon the proprietors of the places of amusement, recreation and entertainment

to which admission is charged, and of the tax on dues and fees, upon the clubs to which such dues and fees are paid. In the one case the proprietor of a place of entertainment must collect the tax from his patron and in the other the club from its member, and both must make monthly returns, **in duplicate,** under oath, and pay over the taxes they have collected to the Collector of Internal Revenue. Such returns are required to be made on an official form which should be obtained from the office of the Collector.

CHAPTER XXXIII

TAX ON MISCELLANEOUS ARTICLES

WAR EXCISE TAXES ON MOTOR VEHICLES, MUSICAL INSTRUMENTS, PICTURE FILMS, SPORTING GOODS, TOILET ARTICLES, PROPRIETARY MEDICINES, CHEWING GUM, JEWELRY, CAMERAS, AND PLEASURE BOATS.

These taxes are imposed by Title VI of the War Revenue Act of October 3, 1917.

They were effective the day after the passage of the law—or October 4, 1917.

The tax rates upon the various vehicles and articles follow.

500.—AUTOMOBILE AND MOTORCYCLES.

The tax is at the rate of **3 per cent** of the price for which any manufacturer, producer or importer sells any automobile, automobile truck, automobile wagon or motorcycle.

501.—PIANO PLAYERS, PHONOGRAPHS, ETC.

The tax is at the rate of **3 per cent** of the price for which any manufacturer, producer or importer sells any piano player, graphophone, phonograph, talking machine or record used in connection with such instruments.

502.—MOVING PICTURE FILMS.

The tax is at the rate of **one-fourth of one cent** per linear foot in the case of all films which have not been exposed, when sold by the manufacturer or importer.

And at the rate of **one-half of one cent** per linear foot in the case of positive moving-picture films containing a picture ready for projection, when sold or leased by the manufacturer, producer, or importer.

503.—JEWELRY.

The tax is at the rate of **3 per cent** of the price for which any manufacturer, producer or importer sells any article commonly or commercially known as jewelry, whether real or imitation.

504.—SPORTING GOODS.

The tax is at the rate of **3 per cent** of the price for which any manufacturer, producer or importer sells the following sporting goods—

Tennis rackets	Golf clubs
Baseball bats	Lacrosse sticks
Fishing rods and reels	Billiard and pool tables
Dice	Chess and Checker Boards and pieces

Balls of all kinds, including baseballs, foot balls, tennis, golf, lacrosse, billiard and pool balls.

Games and parts of games, **except playing cards and children's toys and games.**

505.—TOILET ARTICLES.

The tax is at the rate of **2 per cent** of the price for which any manufacturer, producer or importer sells the following toilet articles—

Perfumes	Toilet waters
Essences	Cosmetics
Extracts	Petroleum jellies
Hair oils	Pomades
Hair dressings	Hair restoratives
Tooth and mouth washes	Hair dyes
Dentifrices	Tooth pastes
Toilet soaps and powders	Aromatic cachous

Or any similar article or preparation, whatever its name, used for toilet purposes.

506.—PROPRIETARY MEDICINES.

The tax is at the rate of **2 per cent** of the price for which any

manufacturer, producer or importer sells any proprietary medicine in the form of—

Pills	Tablets
Powders	Tinctures
Troches or lozenges	Sirups
Anodynes	Medicinal cordials or bitters
Tonics	Plasters
Liniments	Salves
Ointments	Pastes
Drops	Essences
Spirits	Oils

Waters, except those subject to the tax imposed upon "soft drinks," and

All medicinal preparations or compounds, in the making of which the manufacturer or producer claims to follow any private formula, secret or occult art,

Or in the making of which he claims to have any exclusive right,

Or which are made and offered for sale under letters patent or trade-mark,

Or which, if prepared by any formula, published or unpublished, are offered for sale as proprietary medicines, or as remedies or specifics for any disease or affection whatever of the human or animal body.

507.—CHEWING GUM.

The tax is at the rate of **2 per cent** of the price for which any manufacturer, producer or importer sells any chewing gum or substitute for chewing gum.

508.—CAMERAS.

The tax is at the rate of **3 per cent** of the price for which any manufacturer, producer or importer sells any camera.

509.—COLLECTION OF THE TAXES.

A monthly return under oath, **in duplicate,** must be made and the tax must be paid to the Collector of Internal Revenue by every manufacturer, producer or importer of any of the articles enumerated in the preceding paragraphs of this chapter. This return must be made in the district in which is located the principal place of business of the manufacturer, producer or importer. The official form for this return can be obtained from the Collector.

510.—BASIS OF THE TAXES.

As hereinbefore explained, the basis of the tax upon the sale of each article or class of articles enumerated in this schedule is the price for which the manufacturer, producer or importer sells the articles; and liability is incurred when the articles are sold.

511.—TAX UPON WHOLESALE STOCKS.

The act imposes a tax at **one-half the regular rate** upon stocks of all the articles enumerated above, except moving-picture films, which on October 4, 1917 were held and intended for sale by a wholesale dealer who is not the manufacturer, producer or importer.

Under the law return under oath should have been made in any such case to the Collector of Internal Revenue within 30 days after October 3, 1917. The statute provides, however, against the necessity of immediate tax payment by a clause to the effect that payment may be deferred for not more than seven months from October 3, 1917 upon the filing of a bond for payment with sureties acceptable to the Treasury Department. The official form for such bond should be obtained from the Collector of Internal Revenue.

Articles sold and delivered prior to May 9, 1917, but with title reserved in the seller as security for payment of the amount due, are not to be included in any stock return made by a wholesale dealer.

512.—TAX UPON PLEASURE BOATS.

In the War Revenue Act is to be found a special excise tax imposed upon the use of all boats not used exclusively for trade or national defense, or not built according to plans and specifications approved by the Navy Department, provided such boats come within the following descriptions:

(a) Yachts, pleasure boats, power boats and sailing boats, of over five net tons, and

(b) Motor boats with fixed engines.

513.—RATES OF BOAT TAX.

The tax rates are as follows:

Boats of over 5 net tons—

Length not over 50 feet	50 cents for each foot
Over 50 and not over 100 feet	$1 for each foot
Over 100 feet	$2 for each foot
Motor boats of not over five net tons with fixed engines	$5

A motor boat does not have to be of over five net tons to be subject to tax. If it is of over five net tons, tax is computed according to its length; if under, the flat rate of $5 applies.

Every motor boat, not used exclusively for trade or national defense, or not built according to plans and specifications approved by the Navy Department, is taxable if it has a fixed engine, whatever its size.

514.—MEASUREMENT OF BOATS.

As the length of a boat, if it is of more than five net tons, is the basis of tax computation, the law provides that the "over-all" length shall govern.

515.—PAYMENT OF BOAT TAX.

This tax must be paid by **the user** of the boat as follows:

1.—First, on the day this tax is made effective, which was October 4, 1917.

2.—And thereafter on July 1 in each year.

3.—Also at the time of original purchase of a new boat if such purchase is on a date other than July 1.

When tax is paid at the time of original purchase on a date other than July 1, the amount to be paid is the same number of twelfths of the full rate of tax as there are calendar months (including the month of purchase) remaining before the following July 1. An example: Suppose a boat is purchased February 10, 1918. There would remain (including the month of February) five calendar months before the following July 1. Therefore, the tax that would be due would be five-twelfths of the regular rate. But on the following July 1 tax would have to be paid again and then at the full rate.

516.—SHOULD GET OFFICIAL FORMS.

Every user of a boat subject to tax should disclose liability to the Collector of Internal Revenue and request the proper official form on which to make return.

CHAPTER XXXIV

TAX ON LIQUORS

DISTILLED SPIRITS, FERMENTED LIQUORS, WINES, ETC.

517.—OLD AND NEW RATES COMBINED.

With reference to the taxes on distilled spirits, wines, such fermented liquors as beer, ale and porter, vermuth, liqueurs, cordials and similar beverages, the present effective rates, combining the old and new rates, will be given. These rates became effective on October 4, 1917.

518.—DISTILLED SPIRITS.

On all distilled spirits in bond on October 4, 1917, or thereafter made or imported into the United States, tax liability accrued at the rate of $2.20 on each proof gallon, or wine gallon if below proof, except that if such spirits should be withdrawn from bond for beverage purposes or for use in the manufacture of a beverage, the tax is increased to $3.20. The tax on such spirits is payable when the spirits are withdrawn from bond. It is computed on full proof gallons and, proportionately, on fractional parts of gallons.

519.—BEER, ALE, PORTER AND OTHER FERMENTED LIQUOR.

On beer, ale, porter and other similar fermented liquor, containing one-half of 1 per cent or more of alcohol, a tax at the rate of $3 a ba rel and, proportionately, on fractional parts of a barrel. A barrel can not contain more than 31 gallons.

520.—WINES, VERMUTH, CORDIALS, ETC.

On all still wines, including vermuth, and on all champagne and other sparkling wines, liqueurs, cordials, artificial or imitation wines or compounds sold as wines, either imported or of domestic production, if removed from the custom-house, or place of manufacture, or bonded premises after October 4, 1917 for sale or consumption, tax is imposed at the following rates:

Wine containing not more than 14 per cent alcohol	8 cents a wine gallon
Wine containing more than 14 per cent but not more than 21 per cent alcohol	20 cents a wine gallon
Wine containing more than 21 per cent but not more than 24 per cent alcohol	50 cents a wine gallon
Wine containing more than 24 per cent alcohol is subject to tax as distilled spirits, with tax computed on the proof gallons.	
Vermuth is taxed as a still wine according to its alcoholic strength.	
Champagne and natural sparkling wine	6 cents a half pint
Wine artificially carbonated	3 cents a half pint
Liqueurs, cordials and similar compounds	3 cents a half pint

521.—GRAPE BRANDY USED IN FORTIFICATION.

On all grape brandy or wine spirits withdrawn by a producer of wines from any fruit distillery or bonded warehouse to be used in the fortification of wine a tax at the rate of 30 cents a proof gallon, if withdrawn after October 4, 1917.

522.—RECTIFIED PRODUCTS.

In addition to the tax on distilled spirits there is also imposed a tax at the rate of 15 cents a proof gallon on rectified spirits and wines, provided the rectification takes place after October 4, 1917, or the rectified products were in the possession of the rectifier on that date. This tax is not applicable to the manufacture of gin by redistillation of a pure spirit over juniper berries and other aromatics; nor is it to be imposed in the case of the blending of wines according to commercial standards or the blending of pure straight whiskies aged in wood for a period of not less than four years when in the blending of such whiskies no other substance than water is added and the proof of the resultant blend is not below ninety.

523.—PERFUMES.

On perfumes containing distilled spirits, imported into the United States after October 4, 1917, an internal revenue tax at the rate of $1.10 a proof gallon and, proportionately, on fractional parts of a proof gallon, in addition to the tax levied by the customs authorities.

524.—FLOOR TAXES.

The above are the continuing taxes. They do not comprehend the taxes that were imposed on floor stocks of distilled spirits, wines, vermuth, cordials, etc., when the law took effect October 4, 1917, or the taxes then imposed on sweet wines held for sale by the producer and brandy that had been withdrawn but not used for the fortification of wine. The returns of all such tax liability are assumed already to have been made.

CHAPTER XXXV

TAX ON SOFT DRINKS

EXTRACTS USED IN THEIR MANUFACTURE, AND CARBONIC ACID GAS.

525.—TAXES ALL NEW.

All the taxes on the so-called soft drinks are new and have been in effect only since October 4, 1917. They are to be paid by the manufacturer, producer or importer, each of whom is required to make a monthly report, or return, under oath to the local Collector of Internal Revenue. The official form on which this return must be made can be obtained from the Collector by personal or written application.

526.—TAX ON SOFT DRINKS.

The tax on the soft drinks is as follows:

On all unfermented grape juice, soft drinks or artificial mineral waters (not carbonated), and all fermented liquors containing less than one-half of 1 per cent alcohol, the tax is 1 cent a gallon when sold by the manufacturer, producer or importer, in bottles or other closed containers.

On all ginger ale, root beer, sarsaparilla, pop, and other carbonated waters or beverages, the tax is 1 cent a gallon when sold by the manufacturer, producer or importer of the carbonic acid gas used in carbonating the beverages.

On all natural mineral waters or table waters the tax is 1 cent a gallon, when sold by the producer, bottler or importer, in bottles or other closed containers, at more than 10 cent a gallon.

527.—TAX ON SIRUPS AND EXTRACTS.

On all prepared sirups or extracts (intended for use in the manufacture or production of soft drinks, by soda fountains, bottling establishments, and other similar places) the tax is imposed when sold by the manufacturer, producer or importer of such sirups or extracts according to the price for which sold, as follows:

If sold for not more than $1.30 a gallon, a tax of 5 cents a gallon; if sold for more than $1.30 but not more than $2 a gallon, a tax of 8 cents a gallon; if sold for more than $2 but not more than $3 a gallon, a tax of 10 cents a gallon; if sold for more than $3 and not more than $4 a gallon, a tax of 15 cents a gallon; if sold for more than $4 a gallon, a tax of 20 cents a gallon.

528.—TAX ON CARBONIC ACID GAS.

On carbonic acid gas in drums or other containers (intended for use in the manufacture or production of carbonated water or other drinks) the tax is 5 cents a pound, when sold by the manufacturer, producer or importer. The tax in this case must be paid by the purchaser to the vendor and the vendor must make return and transmission of the tax to the local Collector of Internal Revenue.

CHAPTER XXXVI

TAX ON TOBACCO

AND ON CIGARETTE PAPERS AND TUBES.

529.—RATES REPRESENT INCREASE.

The present rates of tax on cigars, cigarettes and all forms of tobacco represent material increase over the rates in effect before the passage of the Act of October 3, 1917. They were made effective 30 days after the passage of the act, or November 2, 1917. The rates given here are the present full rates, representing both the old rate and the increase. The manufacturer or importer must pay the tax.

530.—TAX ON CIGARS.

On cigars of all descriptions, made of tobacco or any substitute, manufactured and sold, or removed for consumption or sale, if not weighing more than 3 pounds per thousand, the tax is $1 per thousand.

If weighing more than 3 pounds per thousand, the tax is according to the following schedule:

If manufactured or imported to retail at less than 4 cents each, the tax is $3 per thousand.

If manufactured or imported to retail at 4 cents or more and not more than 7 cents each, the tax is $4 per thousand.

If manufactured or imported to retail at more than 7 cents and not more than 15 cents each, the tax is $6 per thousand.

If manufactured or imported to retail at more than 15 cents and not more than 20 cents each, the tax is $8 per thousand.

If manufactured or imported to retail at more than 20 cents each, the tax is $10 per thousand.

By "retail" is meant the ardinary retail price of a single cigar.

531.—TAX ON CIGARETTES.

On cigarettes weighing not more than 3 pounds per thousand, the tax is $2.05 per thousand; if weighing more than 3 pounds per thousand, the tax is $4.80 per thousand.

532.—TAX ON TOBACCO AND SNUFF.

On all tobacco and snuff manufactured and sold, or removed for consumption or use, after November 2, 1917, the tax is 13 cents per pound.

533.—TAX ON CIGARETTE PAPERS AND TUBES.

On cigarette papers the tax is as follows:

(a) On each package or book of more than 25 but not more than 50 papers....................one-half of 1 cent

(b) On each package or book of more than 50 but not more than 100 papers....................1 cent

(c) On each package or book containing more than 100 papers, 1 cent for each 100 or fraction thereof.

On cigarette tubes, 2 cents for each 100 tubes or fraction thereof.

CHAPTER XXXVII

SPECIAL TAXES

ON OCCUPATIONS

534.—ON VARIOUS OCCUPATIONS.

The following so-called Federal Special taxes are in effect:

Special Taxes

Rectifiers of spirits of less than 500 bbls. a year	$100
Rectifiers of 500 bbls. or more a year	200
Wholesale liquor dealers	100
Retail liquor dealers	25
Wholesale dealers in malt liquors	50
Retail dealers in malt liquors	20
Manufacturers of stills	50
And for stills or worms mfg. each	20
Brewers	
Annual mfg. less than 500 bbls.	50
Annual mfg. 500 bbls. or more	100
Manufacturers of filled cheese	400
Whse. dealers in filled cheese	12
Manufacturers of oleomargarine	600
Whse. dealers in oleo. artificially colored in imitation of butter	480
Whse. dealers in oleo. free from art. coloration	200
Retail dealers in oleo. art. colored in imitation of butter	48
Retail dealers in oleo. free from art. coloration	6
Manufacturers of adulterated butter	600
Wholesale dealers in adulterated butter	480
Retail dealers in adulterated butter	48
Manufacturers of process or renovated butter	50
Manufacturers, packers or repackers of mixed flour	12
Brokers	30
Pawnbrokers	50
Customhouse brokers	10
Shipbrokers	20
Proprietors of theatres, museums, or concert halls:	
Seating capacity not over 250	25
Seating capacity over 250 but not over 500	50
Seating capacity over 500 but not over 800	75
Seating capacity over 800	100

Proprietors of circuses	100
Prop. of public exhibitions not otherwise enumerated	10
Prop. of bowling alleys and billiard rooms (for each alley or table)	5
Manufacturers of Tobacco:	
Annual sales not over 50,000 lbs.	3
Annual sales over 50,000 but not over 100,000 lbs.	6
Annual sales over 100,000 but not over 200,000 lbs.	12
Annual sales over 200,000, for each 1,000 lbs. or fraction thereof	.08
Manufacturers of Cigars:	
Annual sales not over 50,000 cigars	2
Annual sales over 50,000 but not over 100,000	3
Annual sales over 100,000 but not over 200,000	6
Annual sales over 200,000 but not over 400,000	12
Annual sales over 400,000 cigars for each additional 1000 or fraction	.05
Manufacturers of Cigarettes, for each 10,000 or fraction thereof	.03

535.—MUST BE PAID EACH JULY.

The above special taxes on occupations must be paid each July for the Government's fiscal year beginning July 1 of one year and ending June 30 of the following year.

536.—PENALTY OF 50 PER CENT.

A penalty of 50 per cent attaches for failure to disclose liability within the required time. Also any person who engages in a taxable business without having paid the tax is liable to prosecution.

CHAPTER XXXVIII

COURT DECISIONS

UNDER EXCISE AND INCOME TAX LAWS

Below are cited a number of decisions that have touched upon points of controversy arising in connection with the administration of the Income Tax Law and, before it, of the Corporation Excise Tax Law of August 5, 1909.

The headings by which these cases are cited do not, in any sense, cover all the points at issue. They do, however, call attention to questions passed upon by the courts. The text of the decisions cannot be included in this book, but the citations are made in such a way that any person interested should have no difficulty finding without delay any particular case. If the decisions, as cited, are not available, the text of any one of them will be furnished upon written request to any subscriber to this book and the monthly supplement to follow it.

Decisions under the Corporation Excise Tax Act of August 5, 1909 and the first Income Tax Act of October 3, 1913 are given because investigations are still being made under those laws and for the further reason that the decisions are, in the main, applicable to the provisions of the amended Income Tax Law of September 8, 1916 and the War Income Tax Law of October 3, 1917, and, in view of the relation of war-time income to pre-war income, they will be found helpful in connection with the Excess Profits Tax problems.

A particular case should not, however, be considered controlling without first ascertaining whether the law has been changed with respect to the point in question:

BOOK ENTRY OF DEPLETION.

Forty Fort Coal Co. v. Kirkendall, Collector.
U. S. District Court, Pa. (233 Fed. 704)

BOOKKEEPING FACTS DO NOT CONSTITUTE INCOME.
U. S. v. Nipissing Mines Co.
(202 Fed. 893)
Mitchell Bros. v. Doyle.
(225 Fed. 437)
Baldwin Locomotive Works v. McCoach, Collector.
(215 Fed. 967)

CHANGE OF CAPITAL INVESTMENT NOT TAXABLE.
Lynch v. Hornby.
U. S. Circuit Court of Appeals,
Eighth Circuit.

CONSTITUTIONALITY OF INCOME TAX LAW.
Brushaber v. Union Pacific Railroad Co.
U. S. Supreme Court (240 U. S. 1)
Dodge v. Brady, Collector.
U. S. Supreme Court (240 U. S. 122)
Stanton v. Baltic Mining Co. et al
U. S. Supreme Court (240 U. S. 103)
Tyee Realty Co. v. Anderson, Collector.
U. S. Supreme Court (240 U. S. 115)
Thorne v. Anderson, Collector
U. S. Supreme Court (240 U. S. 115)
Dodge v. Osborn, Commissioner,
U. S. Supreme Court (240 U. S. 118)

CORPORATION DISSOLVING BEFORE TIME TO MAKE RETURN.
U. S. v. General Inspection & Loading Co.
(192 Fed. 223)

DEDUCTION OF BANK TAX.
Eliot National Bank v. Gill, Collector.
U. S. Circuit Court of Appeals of the
First Circuit (218 Fed. 600)
Northern Trust Co. v. McCoach, Collector
(215 Fed. 991)
Fidelity Trust Co. v. McCoach, Collector
(215 Fed. 996)
Philadelphia Trust Safe Deposit & Insurance Company v. McCoach, Collector.
(215 Fed. 995)
National Bank of Commerce in St. Louis v. Allen, Collector.
(223 Fed. 472)

DEDUCTIBLE EXPENSES OF RAILROADS.
Grand Rapids & Indiana Railway Co. v. Doyle, Collector
U. S. District Court, Southern Division, Western
District of Michigan.

DIVIDENDS PAID BY SUBSIDIARY CORPORATION TAXABLE TO PARENT CORPORATION.
Southern Pacific Co. v. Lowe, Collector.
U. S. District Court, Southern District
of New York. (238 Fed. 847)

DIVIDENDS PAID BY LESSEE, AS RENTAL, DIRECT TO STOCKHOLDERS OF LESSOR CORPORATION.
Rensselaer & Saratoga Railroad Co. v. Irwin, Collector
U. S. District Court, Northern District of
New York (239 Fed. 739)

DIVIDENDS OUT OF EARNINGS OF PERIOD PRIOR TO JAN. 1, 1913.
Gulf Oil Corporation v. Lewellyn, Collector.
U. S. District Court, Western District of Pennsylvania.

DOING BUSINESS UNDER ACT OF AUGUST 5, 1909.
Flint v. Stone Tracy Co.
U. S. Supreme Court (220 U. S. 107)
Zonne v. Minneapolis Syndicate
U. S. Supreme Court (220 U. S. 187)
McCoach, Collector, v. Minehill Railway Co.
U. S. Supreme Court (228 U. S. 295)
U. S. v. Emery
U. S. Supreme Court (237 U. S. 28)

ENHANCED VALUE ACCRUED PRIOR TO TAX NOT INCOME UNDER TAX LAW.
Lynch v. Turrish.
(236 Fed. 653)

FORCE OF TAX-FREE COVENANT IN BOND.
Urquhart v. Marion Hotel Company.
Supreme Court of Kansas (194 S. W. 1)

HOLDING COMPANIES UNDER ACT OF AUGUST 5, 1909.
Butterick Co. v. U. S.
U. S. District Court, Southern District of New York.
Federal Publishing Co. v. U. S.
U. S. District Court, Southern District of New York.

INTEREST RECEIVED AND PAID BY BROKERS CARRYING SECURITIES.
Altheimer & Rawlings Investment Co. v. Allen, Collector.
U. S. District Court, Eastern Division of the
Eastern District of Missouri.

INSURANCE COMPANIES — INCOME RETURNABLE, RECEIPT BY AGENTS, RESERVES.
Maryland Casualty Co. v. U. S.
U. S. Court of Claims.
Mutual Benefit Life Ins. Co. v. Herold
U. S. District Court, District of New Jersey.
(198 Fed. 199)
Insurance Company of North America v. McCoach
(218 Fed. 905)
Connecticut Mutual Life Ins. Co. v. Eaton
(218 Fed. 188)

LIABILITY OF LESSEE, UNDER TERMS OF LEASE, TO PAY TAX ON RENTAL.
Little Schuylkill Nav., R.R. & Coal Co. v. P. & R. Ry. Co.
Common Pleas Court Philadelphia
County, Pa. (44Pa. County Court Reports 197)

LIABILITY OF TENANT, UNDER LEASE COVENANT TO PAY ALL TAXES ON THE PROPERTY, FOR AMOUNT SUFFICIENT TO PAY NORMAL TAX OF LANDLORD ON RENTAL.
Sutter et al v. Jordan Marsh Co.
Supreme Judicial Court of Mass.
(113 N. E. 580)

MAILING OF ASSESSMENT NOTICE LEGAL.
U. S. v. General Inspection & Loading Co.
(204 Fed. 657)

ONLY SUCH GAINS AND PROFITS AS CONSTITUTE INCOME TAXABLE.
Gray v. Darlington.
(15 Wall 63)

OPERATION OF PUBLIC UTILITY DOES NOT RELIEVE FROM TAX.
Union Hollywood Water Co. v. Carter, Collector.
U. S. Circuit Court of Appeals. (238 Fed. 329)

RENEWAL PREMIUMS ON INSURANCE POLICIES WRITTEN BEFORE TAX LAW ENACTED.
Edwards v. Keith, Collector.
U. S. Circuit Court of Appeals of the Second Circuit (231 Fed. 110)

ROYALTIES RECEIVED FROM LESSEES INCOME.
Von Baumbach, Collector, Petitioner v. Sargent Land Co.
U. S. Supreme Court. (Date, Jan. 15, 1917)

SPECIFIC EXEMPTION IN RELATION TO ADDITIONAL TAX.
Cohen v. Lowe, Collector
U. S. District Court, Southern District of New York (234 Fed. 474)

SUIT TO RECOVER TAX BY TERMINAL RAILROAD CORPORATION—THE DOING OF BUSINESS UNDER ACT OF AUGUST 5, 1909.
Boston Terminal Co. v. Gill, Collector.
U. S. District Court, District of Massachusetts.

SUIT TO ENJOIN COLLECTION OF PENALTIES.
Kohlhamer v. Smietanka, Collector.
(239 Fed. 408)

SUIT BY GOVERNMENT TO COLLECT TAX—NO LIMITATION.
U. S. v. Grand Rapids & Indiana Railway Co.
U. S. District Court, Southern Division, Western District of Michigan (239 Fed. 153)

SUIT TO RECOVER TAXES—WHO MUST BE SUED.
Philadelphia, Harrisburg & Pittsburg Railroad Company v. Lederer, Collector.
U. S. Circuit Court of Appeals of the Third Circuit.
Roberts v. Lowe, Collector.
U. S. District Court, Southern District of New York.

STOCK DIVIDENDS RESULTING FROM CAPITALIZATION OF SURPLUS EARNED PRIOR TO JAN. 1, 1913.
Towne v. Eisner, Collector.
U. S. District Court, Southern District of New York.

SUIT TO RESTRAIN ASSESSMENT AND COLLECTION OF TAX.
Dodge v. Osborn, Commissioner.
U. S. Supreme Court (240 U. S. 118)

SUIT TO RECOVER TAXES—TIME LIMITATION.

Mail & Newspaper Transportation Co. v. Anderson, Collector.
Circuit Court of Appeals, Second
Circuit, New York. (234 Fed. 590)

TAXABILITY OF PROCEEDS FROM ORE SALES.

Stratton's Independence v. Howbert
U. S. Supreme Court (231 U. S. 399)

TAXABILITY UNDER ACT OF OCT. 3, 1913, OF INCOME RECEIVED BY NON-RESIDENT ALIENS FROM DOMESTIC STOCKS AND BONDS.

De Ganay v. Lederer, Collector.
U. S. District Court, Eastern District of
Pennsylvania (239 Fed. 568)

TAXABILITY OF INCOME ACCRUED TO PERSON DYING AFTER MARCH 1, 1913, BUT BEFORE OCTOBER 3, 1913.

Brady et al, executors v. Anderson, Collector.
U. S. District Court, Southern District
of New York.

VALUE OF STOCK AS CARRIED ON BOOKS.

U. S. v. Guggenheim Exploration Co.
U. S. District Court, Southern District
of New York. (238 Fed. 231)

APPENDIX

Containing Text of Laws

[Note: In the text of the Income Tax and Excess Profits Tax laws an arbitrary system of breaking up solid text and numbering lines (in the margin) has been introduced to facilitate reference according to direction of the Index.

When the abbreviation **(LL)** appears in the Index, the reference is to **(Law Line Numbers).** For example: **(App. p. 2 LL 15),** in the Index, means, **(Appendix, Page 2, Law Line 15)].**

THE INCOME TAX.

Act of September 8, 1916, as amended by the Act of October 3, 1917.

Part I.—On Individuals

1 Sec. 1. (a) That there shall be levied, assessed, collected, and paid annually upon the entire net income received in the preceding calendar year from all sources

2 by every individual, a citizen or resident of the United States,

3 a tax of two per centum upon such income;

4 and a like tax shall be levied, assessed, collected, and paid annually upon the entire net income received in the preceding calendar year from all sources within the United States by every individual, a non-resident alien, including interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise.

5 (b) In addition to the income tax imposed by subdivision (a) of this section (herein referred to as the normal tax) there shall be levied, assessed, collected, and paid upon the total net income of every individual,

6 or, in the case of a non-resident alien, the total net income received from all sources within the United States,

7 an additional income tax (herein referred to as the additional tax) of

8 one per centum per annum upon the amount by which such total net income exceeds $20,000 and does not exceed $40,000,

9 two per centum per annum upon the amount by which such total net income exceeds $40,000 and does not exceed $60,000,

10 three per centum per annum upon the amount by which such total net income exceeds $60,000 and does not exceed $80,000,

11 four per centum per annum upon the amount by which such total net income exceeds $80,000 and does not exceed $100,000,

12 five per centum per annum upon the amount by which such total net income exceeds $100,000 and does not exceed $150,000,

13 six per centum per annum upon the amount by which such total net income exceeds $150,000 and does not exceed $200,000,

14 seven per centum per annum upon the amount by which such total net income exceeds $200,000 and does not exceed $250,000,

15 eight per centum per annum upon the amount by which such total net income exceeds $250,000 and does not exceed $300,000,

16 nine per centum per annum upon the amount by which such total net income exceeds $300,000 and does not exceed $500,000,

17 ten per centum per annum upon the amount by which such total net income exceeds $500,000 and does not exceed $1,000,000,

18 eleven per centum per annum upon the amount by which such total net income exceeds $1,000,000 and does not exceed $1,500,000,

19 twelve per centum per annum upon the amount by which such total net income exceeds $1,500,000 and does not exceed $2,000,000 and

20 thirteen per centum per annum upon the amount by which such total net income exceeds $2,000,000.

21 For the purpose of the additional tax there shall be included as income the income derived from dividends on the capital stock or from the net earnings of any corporation, joint-stock company or association, or insurance company,

22 except that in the case of non-resident aliens such income derived from sources without the United States shall not be included.

23 All the provisions of this title relating to the normal tax on individuals, so far as they are applicable and are not inconsistent with this subdivision and section three, shall apply to the imposition, levy, assessment, and collection of the additional tax imposed under this subdivision.

24 (c) The foregoing normal and additional tax rates shall apply to the entire net income, except as hereinafter provided, received by every taxable person in the calendar year nineteen hundred and sixteen and in each calendar year thereafter.

25 Sec. 2. (a) That, subject only to such exemptions and deductions as are hereinafter allowed, the net income of a taxable person shall include gains, profits, and income, derived from

26 salaries, wages, or compensation for personal service of whatever kind and in whatever form paid,

27 or from professions, vocations, businesses, trade, commerce,

28 or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property,

29 also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit,

30 or gains or profits and income derived from any source whatever.

31 (b) Income received by estates of deceased persons during the period of administration or settlement of the estate, shall be subject to the normal and additional tax and taxed to their estates, and

32 also such income of estates or any kind of property held in trust, including such income accumulated in trust for the benefit of unborn or unascertained persons, or persons with contingent interests, and income held for future distribution under the terms of the will or trust shall be likewise taxed,

33 the tax in each instance, except when the income is returned for the purpose of the tax by the beneficiary, to be assessed to the executor, administrator, or trustee, as the case may be:

34 Provided, That where the income is to be distributed annually or regularly between existing heirs or legatees, or beneficiaries the rate of tax and method of computing the same shall be based in each case upon the amount of the individual share to be distributed.

35 Such trustees, executors, administrators, and other fiduciaries are hereby indemnified against the claims or demands of every beneficiary

for all payments of taxes which they shall be required to make under the provisions of this title, and they shall have credit for the amount of such payments against the beneficiary or principal in any accounting which they make as such trustees or other fiduciaries.

36 (c) For the purpose of ascertaining the gain derived from the sale or other disposition of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such gain derived.

Additional Tax Includes Undistributed Profits

37 Sec. 3. For the purpose of the additional tax, the taxable income of any individual shall include the share to which he would be entitled of the gains and profits, if divided or distributed, whether divided or distributed or not, of all corporations, joint-stock companies or associations, or insurance companies, however created or organized, formed or fraudulently availed of for the purpose of preventing the imposition of such tax through the medium of permitting such gains and profits to accumulate instead of being divided or distributed;

38 and the fact that any such corporation, joint-stock company or association, or insurance company, is a mere holding company, or that the gains and profits are permitted to accumulate beyond the reasonable needs of the business, shall be prima facie evidence of a fraudulent purpose to escape such tax;

39 but the fact that the gains and profits are in any case permitted to accumulate and become surplus shall not be construed as evidence of a purpose to escape the said tax in such case unless the Secretary of the Treasury shall certify that in his opinion such accumulation is unreasonable for the purposes of the business.

40 When requested by the Commissioner of Internal Revenue, or any district collector of internal revenue, such corporation, joint-stock company or association, or insurance company shall forward to him a correct statement of such gains and profits and the names and addresses of the individuals or shareholders who would be entitled to the same if divided or distributed.

Income Exempt from Law

41 Sec. 4. The following income shall be exempt from the provisions of this title:

42 The proceeds of life insurance policies paid to individual beneficiaries upon the death of the insured; the amount received by the insured, as a return of premium or premiums paid by him under life insurance, endowment, or annuity contracts, either during the term or at the maturity of the term mentioned in the contract or upon surrender of the contract;

43 the value of property acquired by gift, bequest, devise, or descent (but the income from such property shall be included as income);

44 interest upon the obligations of a State or any political subdivision thereof or upon the obligations of the United States (but, in the case of obligations of the United States issued after September first, nineteen hundred and seventeen, only if and to the extent provided in the act authorizing the issue thereof) or its possessions or securities issued under the provisions of the Federal Farm Loan Act of July seventeenth, nineteen hundred and sixteen;

45 the compensation of the present President of the United States during the term for which he has been elected

46 and the judges of the supreme and inferior courts of the United States now in office,

47 and the compensation of all officers and the employees of a State, or any political subdivision thereof, except when such compensation is paid by the United States Government.

Deductions Allowed

48 Sec. 5. That in computing net income in the case of a citizen or resident of the United States—

49 (a) For the purpose of the tax there shall be allowed as deductions—

50 First. The necessary expenses actually paid in carrying on any business or trade, not including personal, living, or family expenses;

51 Second. All interest paid within the year on his indebtedness except on indebtedness incurred for the purchase of obligations or securities the interest upon which is exempt from taxation as income under this title;

52 Third. Taxes paid within the year imposed by the authority of the United States (except income and excess profits taxes) or of its Territories, or possessions, or any foreign country, or by the authority of any State, county, school district, or municipality, or other taxing subdivision of any State, not including those assessed against local benefits;

53 Fourth. Losses actually sustained during the year, incurred in his business or trade, or arising from fires, storms, shipwreck, or other casualty, and from theft, when such losses are not compensated for by insurance or otherwise:

54 Provided, That for the purpose of ascertaining the loss sustained from the sale or other disposition of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such loss sustained;

55 Fifth. In transactions entered into for profit but not connected with his business or trade, the losses actually sustained therein during the year to an amount not exceeding the profits arising therefrom;

56 Sixth. Debts due to the taxpayer actually ascertained to be worthless and charged off within the year;

57 Seventh. A reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business or trade;

58 Eighth. (a) In the case of oil and gas wells a reasonable allowance for actual reduction in flow and production to be ascertained not by the flush flow, but by the settled production or regular flow;

59 (b) in the case of mines a reasonable allowance for depletion thereof not to exceed the market value in the mine of the product thereof, which has been mined and sold during the year for which the return and computation are made.

60 such reasonable allowance to be made in the case of both (a) and (b) under rules and regulations to be prescribed by the Secretary of the Treasury:

61 Provided, That when the allowances authorized in (a) and (b) shall equal the capital originally invested, or in case of purchase made prior to March first, nineteen hundred and thirteen, the fair market value as of that date, no further allowance shall be made.

62 No deduction shall be allowed for any amount paid out for new buildings, permanent improvements, or betterments, made to increase the value of any property or estate.

63 and no deduction shall be made for any amount of expense of restoring property or making good the exhaustion thereof for which an allowance is or has been made.

Ninth. Contributions or gifts actually made within the year to corporations or associations organized and operated exclusively for religious, charitable, scientific, or educational purposes, or to societies for the prevention of cruelty to children or animals, no part of the net income of which inures to the benefit of any private stockholder or individual, to an amount not in excess of fifteen per centum of the taxpayer's taxable net income as computed without the benefit of this paragraph. Such contributions or gifts shall be allowable as deductions only if verified under rules and regulations prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury.

Credits Allowed

64 (b) For the purpose of the normal tax only, the income embraced in a personal return shall be credited with the amount received as dividends upon the stock or from the net earnings of any corporation, joint-

stock company or association, trustee, or insurance company, which is taxable upon its net income as hereinafter provided;

65 (c) A like credit shall be allowed as to the amount of income, the normal tax upon which has been paid or withheld for payment at the source of the income under the provisions of this title.

Non-Resident Aliens

66 Sec. 6. That in computing net income in the case of a non-resident alien—

67 (a) For the purpose of the tax there shall be allowed as deductions—

68 First. The necessary expenses actually paid in carrying on any business or trade conducted by him within the United States, not including personal, living, or family expenses;

69 Second. The proportion of all interest paid within the year by such person on his indebtedness (except on indebtedness incurred for the purchase of obligations or securities the interest upon which is exempt from taxation as income under this title) which the gross amount of his income for the year derived from sources within the United States bears to the gross amount of his income for the year derived from all sources within and without the United States, but this deduction shall be allowed only if such person includes in the return required by section eight all the information necessary for its calculation;

70 Third. Taxes paid within the year imposed by the authority of the United States (except income and excess profits taxes), or of its Territories, or possessions, or by the authority of any State, county, school district, or municipality, or other taxing subdivision of any State, paid within the United States, not including those assessed against local benefits;

71 Fourth. Losses actually sustained during the year, incurred in business or trade conducted by him within the United States, and losses of property within the United States arising from fires, storms, shipwreck, or other casualty, and from theft, when such losses are not compensated for by insurance or otherwise:

72 Provided, That for the purpose of ascertaining the amount of such loss or losses sustained in trade, or speculative transactions not in trade, from the same or any kind of property acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such loss or losses sustained;

73 Fifth. In transactions entered into for profit but not connected with his business or trade, the losses actually sustained therein during the year to an amount not exceeding the profits arising therefrom in the United States;

74 Sixth. Debts arising in the course of business or trade conducted by him within the United States due to the taxpayer actually ascertained to be worthless and charged off within the year;

75 Seventh. A reasonable allowance for the exhaustion, wear and tear of property within the United States arising out of its use or employment in the business or trade:

76 (a) in the case of oil and gas wells a reasonable allowance for actual reduction in flow and production to be ascertained not by the flush flow, but by the settled production or regular flow;

77 (b) in the case of mines a reasonable allowance for depletion thereof not to exceed the market value in the mine of the product thereof which has been mined and sold during the year for which the return and computation are made,

78 such reasonable allowance to be made in the case of both (a) and (b) under rules and regulations to be prescribed by the Secretary of the Treasury:

79 Provided, That when the allowance authorized in (a) and (b) shall equal the capital originally invested, or in case of purchase

made prior to March first, nineteen hundred and thirteen, the fair market value as of that date, no further allowance shall be made.

80 No deduction shall be allowed for any amount paid out for new buildings, permanent improvements, or betterments, made to increase the value of any property or estate,

81 and no deduction shall be made for any amount of expense of restoring property or making good the exhaustion thereof for which an allowance is or has been made.

82 (b) There shall also be allowed the credits specified by subdivisions (b) and (c) of section five.

83 (c) A nonresident alien individual shall receive the benefit of the deductions and credits provided for in this section only by filing or causing to be filed with the Collector of Internal Revenue a true and accurate return of his total income, received from all sources, corporate or otherwise, in the United States, in the manner prescribed by this title; and in case of his failure to file such return the Collector shall collect the tax on such income, and all property belonging to such nonresident alien individual shall be liable to distraint for the tax.

Personal Exemption.

84 Sec. 7. That for the purpose of the normal tax only, there shall be allowed as an exemption in the nature of a deduction from the amount of the net income of each citizen or resident of the United States, ascertained as provided herein, the sum of $3,000,

85 plus $1,000 additional if the person making the return be a head of a family or a married man with a wife living with him,

86 or plus the sum of $1,000 additional if the person making the return be a married woman with a husband living with her;

87 but in no event shall this additional exemption of $1,000 be deducted by both a husband and a wife:

88 Provided, That only one deduction of $4,000 shall be made from the aggregate income of both husband and wife when living together:

89 Provided further, That if the person making the return is the head of a family there shall be an additional exemption of $200 for each child dependent upon such person, if under eighteen years of age, or if incapable of self-support because mentally or physically defective, but this provision shall operate only in the case of one parent in the same family;

90 Provided further, That guardians or trustees shall be allowed to make this personal exemption as to income derived from the property of which such guardian or trustee has charge in favor of each ward or cestui que trust:

91 Provided further, That in no event shall a ward or cestui que trust be allowed a greater personal exemption than as provided in this section from the amount of net income received from all sources.

92 There shall also be allowed an exemption from the amount of the net income of estates of deceased citizens or residents of the United States during the period of administration or settlement,

93 and of trust or other estates of citizens or residents of the United States the income of which is not distributed annually or regularly under the provisions of subdivision (b) of section two,

94 the sum of $3,000, including such deductions as are allowed under section five.

Returns

95 Sec. 8. (a) The tax shall be computed upon the net income, as thus ascertained, of each person subject thereto, received in each preceding calendar year ending December thirty-first.

96 (b) On or before the first day of March, nineteen hundred and seventenn, and the first day of March in each year thereafter, a true and accurate return under oath shall be made by each person of lawful age, except as hereinafter provided, having a net income of $3,000 or over for the taxable year

97 to the collector of internal revenue for the district in which such person has his legal residence or principal place of business, or if there be no

legal residence or place of business in the United States, then with the collector of internal revenue at Baltimore, Maryland,

98 in such form as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe, setting forth specifically the gross amount of income from all separate sources, and from the total thereof deducting the aggregate items of allowances herein authorized:

99 Provided, That the Commissioner of Internal Revenue shall have authority to grant a reasonable extension of time, in meritorious cases, for filing returns of income by persons residing or traveling abroad who are required to make and file returns of income and who are unable to file said returns on or before March first of each year:

100 Provided further, That the aforesaid return may be made by an agent when by reason of illness, absence, or non-residence the person liable for said return is unable to make and render the same, the agent assuming the responsibility of making the return and incurring penalties provided for erroneous, false, or fraudulent return.

101 (c) Guardians, trustees, executors, administrators, receivers, conservators, and all persons, corporations, or associations, acting in any fiduciary capacity, shall make and render a return of the income of the person, trust, or estate for whom or which they act, and be subject to all the provisions of this title which apply to individuals. Such fiduciary shall make oath that he has sufficient knowledge of the affairs of such person, trust, or estate to enable him to make such return and that the same is, to the best of his knowledge and belief, true and correct, and be subject to all the provisions of this title which apply to individuals:

102 Provided, That a return made by one of two or more joint fiduciaries filed in the district where such fiduciary resides, under such regulations as the Secretary of the Treasury may prescribe, shall be a sufficient compliance with the requirements of this paragraph:

103 Provided further, That no return of income not exceeding $3,000 shall be required except as in this title otherwise provided.

104 . (e) Persons carrying on business in partnership shall be liable for income tax only in their individual capacity, and the share of the profits of the partnership to which any taxable partner would be entitled if the same were divided, whether divided or otherwise, shall be returned for taxation and the tax paid under the provisions of this title:

105 Provided, That from the net distributive interests on which the individual members shall be liable for tax, normal and additional, there shall be excluded their proportionate shares received from interest on the obligations of a State or any political or taxing subdivision thereof, and upon the obligations of the United States (if and to the extent that it is provided in the act authorizing the issue of such obligations of the United States that they are exempt from taxation) and its possessions,

106 and that for the purpose of computing the normal tax there shall be allowed a credit, as provided by section five, subdivision (b), for their proportionate share of the profits derived from dividends.

107 Such partnership, when requested by the Commissioner of Internal Revenue or any district collector, shall render a correct return of the earnings, profits, and income of the partnership, except income exempt under section four of this Act, setting forth the item of the gross income and the deductions and credits allowed by this title, and the names and addresses of the individuals who would be entitled to the net earnings, profits, and income, if distributed.

108 A partnership shall have the same privilege of fixing and making returns upon the basis of its own fiscal year as is accorded to corporations under this title.

109 If a fiscal year ends during nineteen hundred and sixteen or a subsequent calendar year for which there is a rate of tax different from the rate for the preceding calendar year, then

110 (1) the rate for such preceding calendar year shall apply to an amount of each partner's share of such partnership profits equal to the proportion

which the part of such fiscal year falling within such calendar year bears to the full fiscal year, and (2) the rate for the calendar year during which such fiscal year ends shall apply to the remainder.

111 (f) In every return shall be included the income derived from dividends on the capital stock or from the net earnings of any corporation, joint-stock company or association, or insurance company,

112 except that in the case of non-resident aliens such income derived from sources without the United States shall not be included.

113 (g) An individual keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect his income, may, subject to regulations made by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, make his return upon the basis upon which his accounts are kept, in which case the tax shall be computed upon his income as so returned.

Assessment and Administration

114 Sec. 9. (a) That all assessments shall be made by the Commissioner of Internal Revenue and all persons shall be notified of the amount for which they are respectively liable on or before the first day of June of each successive year, and said amounts shall be paid on or before the fifteenth day of June,

115 except in cases of refusal or neglect to make such return and in cases of erroneous, false, or fraudulent returns, in which cases the Commissioner of Internal Revenue shall, upon the discovery thereof, at any time within three years after said return is due, or has been made, make a return upon information obtained as provided for in this title or by existing law, or require the necessary corrections to be made, and the assessment made by the Commissioner of Internal Revenue thereon shall be paid by such person or persons immediately upon notification of the amount of such assessment;

116 and to any sum or sums due and unpaid after the fifteenth day of June in any year, and for ten days after notice and demand thereof by the collector, there shall be added the sum of five per centum on the amount of tax unpaid, and interest at the rate of one per centum per month upon said tax from the time the same became due, except from the estates of insane, deceased, or insolvent persons.

117 (b) All persons, corporations, partnerships, associations, and insurance companies, in whatever capacity acting, including

118 lessees or mortgagors of real or personal property,

119 trustees acting in any trust capacity,

120 executors, administrators, receivers, conservators,

121 employers,

122 and all officers and employees of the United States

123 having the control, receipt, custody, disposal, or payment of interest, rent, salaries, wages, premiums, annuities, compensation, remuneration, emoluments, or other fixed or determinable annual or periodical gains, profits, and income of any nonresident alien individual,

124 other than income derived from dividends on capital stock, or from the net earnings of a corporation, joint-stock company or association, or insurance company, which is taxable upon its net income as provided in this title,

125 are hereby authorized and required to deduct and withhold from such annual or periodical gains, profits, and income such sum as will be sufficient to pay the normal tax imposed thereon by this title.

126 and shall make return thereof on or before March first of each year and, on or before the time fixed by law for the payment of the tax, shall pay the amount withheld to the officer of the United States Government authorized to receive the same;

127 and they are each hereby made personally liable for such tax, and they are each hereby indemnified against every person, corporation, partnership, association, or insurance company, or demand whatsoever for all payments which they shall make in pursuance and by virtue of this title.

128 (c) The amount of the normal tax hereinbefore imposed shall also be deducted and withheld from fixed or determinable annual or periodical gains, profits, and income derived from interest upon bonds and mortgages, or deeds of trust or other similar obligations of corporations, joint-stock companies, associations, and insurance companies (if such bonds, mortgages, or other obligations contain a contract or provision by which the obligor agrees to pay any portion of the tax imposed by this title upon the obligee or to reimburse the obligee for any portion of the tax or to pay the interest without deduction for any tax which the obligor may be required or permitted to pay thereon or to retain therefrom under any law of the United States),

129 whether payable annually or at shorter or longer periods

130 and whether such interest is payable to a nonresident alien individual or to an individual citizen or resident of the United States,

131 subject to the provisions of the foregoing subdivision (b) of this section requiring the tax to be withheld at the source and deducted from annual income and returned and paid to the Government,

131 unless the person entitled to receive such interest shall file with the withholding agent, on or before February first, a signed notice in writing claiming the benefit of an exemption under section seven of this title.

132 (f) All persons, corporations, partnerships, or associations, undertaking as a matter of business or for profit the collection of foreign payments of interest or dividends by means of coupons, checks, or bills of exchange shall obtain a license from the Commissioner of Internal Revenue,

133 and shall be subject to such regulations enabling the Government to obtain the information required under this title, as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe;

134 and whoever knowingly undertakes to collect such payments as aforesaid without having obtained a license therefor, or without complying with such regulations,

135 shall be deemed guilty of a misdemeanor and for each offense be fined in a sum not exceeding $5,000, or imprisoned for a term not exceeding one year, or both, in the discretion of the court.

136 (g) The tax herein imposed upon gains, profits, and incomes not falling under the foregoing and not returned and paid by virtue of the foregoing or as otherwise provided by law

137 shall be assessed by personal return under rules and regulations to be prescribed by the Commissioner of Internal Revenue and approved by the Secretary of the Treasury.

138 The intent and purpose of this title is

139 that all gains, profits, and income of a taxable class, as defined by this title,

140 shall be charged and assessed with the corresponding tax, normal and additional, prescribed by this title,

141 and said tax shall be paid by the owner of such income, or the proper representative having the receipt, custody, control, or disposal of the same.

142 For the purpose of this title ownership or liability shall be determined as of the year for which a return is required to be rendered.

143 The provisions of this section,

144 except subdivision (c), relating to the deduction and payment of the tax at the source of income

145 shall only apply to the normal tax hereinbefore imposed upon nonresident alien individuals.

Part II.—On Corporations

146 Sec. 10. (a) That there shall be levied, assessed, collected, and paid annually upon the total net income received in the preceding calendar year from all sources

147 by every corporation, joint-stock company or association, or insurance company, organized in the United States,

148 no matter how created or organized,

149 but not including partnerships,

150 a tax of two per centum upon such income;

151 and a like tax shall be levied, assessed, collected, and paid annually upon the total net income received in the preceding calendar year from all sources within the United States

152 by every corporation, joint-stock company or association, or insurance company, organized, authorized, or existing under the laws of any foreign country,

153 including interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise,

154 and including the income derived from dividends on capital stock or from net earnings of resident corporations, joint-stock companies or associations, or insurance companies, whose net income is taxable under this title.

155 The foregoing tax rate shall apply to the total net income received by every taxable corporation, joint-stock company or association, or insurance company in the calendar year nineteen hundred and sixteen and in each year thereafter,

156 except that if it has fixed its own fiscal year under the provisions of existing law, the foregoing rate shall apply to the proportion of the total net income returned for the fiscal year ending prior to December thirty-first, nineteen hundred and sixteen, which the period between January first, nineteen hundred and sixteen, and the end of such fiscal year bears to the whole of such fiscal year, and the rate [one per centum] fixed in Section II of the Act approved October third, nineteen hundred and thirteen, entitled "An Act to reduce tariff duties and to provide revenue for the Government, and for other purposes," shall apply to the remaining portion of the total net income returned for such fiscal year.

157 For the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition by a corporation, joint-stock company or association, or insurance company, of property, real. personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first nineteen hundred and thirteen, shall be the basis for determining the amount of such gain derived or loss sustained.

(b) In addition to the income tax imposed by subdivision (a) of this section there shall be levied, assessed, collected, and paid annually an additional tax of ten per centum upon the amount, remaining undistributed six months after the end of each calendar or fiscal year, of the total net income of every corporation, joint-stock company or association, or insurance company, received during the year, as determined for the purposes of the tax imposed by such subdivision (a), but not including the amount of any income taxes paid by it within the year imposed by the authority of the United States.

The tax imposed by this subdivision shall not apply to that portion of such undistributed net income which is actually invested and employed in the business or is retained for employment in the reasonable requirements of the business or is invested in obligations of the United States issued after September first, nineteen hundred and seventeen: Provided, That if the Secretary of the Treasury ascertains and finds that any portion of such amount so retained at any time for employment in the business is not so employed or is not reasonably required in the business a tax of fifteen per centum shall be levied, assessed, collected, and paid thereon.

The foregoing tax rates shall apply to the undistributed net income received by every taxable corporation, joint-stock company or association, or insurance company in the calendar year nineteen hundred and seventeen and in each year thereafter, except that if it has fixed its own fiscal year under the provisions of existing law, the foregoing rates shall apply to the proportion of the taxable undistributed net income returned for the fiscal year ending prior to December thirty-first, nineteen hundred and seventeen, which the period between January first, nineteen hundred and seventeen, and the end of such fiscal year bears to the whole of such fiscal year.

Conditional and Other Exemptions

158 Sec. 11. (a) That there shall not be taxed under this title any income received by any—

159 First. Labor, agricultural, or horticultural organization;

160 Second. Mutual savings bank not having a capital stock represented by shares;

161 Third. Fraternal beneficiary society, order, or association, operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association or their dependents;

162 Fourth. Domestic building and loan association and co-operative banks without capital stock organized and operated for mutual purposes and without profit;

163 Fifth. Cemetery company owned and operated exclusively for the benefit of its members;

164 Sixth. Corporation or association organized and operated exclusively for religious, charitable, scientific, or educational purposes, no part of the net income of which inures to the benefit of any private stockholder or individual;

165 Seventh. Business league, chamber of commerce, or board of trade not organized for profit and no part of the net income of which inures to the benefit of any private stockholder or individual;

166 Eighth. Civic league or organization not organized for profit but operated exclusively for the promotion of social welfare;

167 Ninth. Club organized and operated exclusively for pleasure, recreation, and other non-profitable purposes, no part of the net income of which inures to the benefit of any private stockholder or member;

168 Tenth. Farmers' or other mutual hail, cyclone, or fire insurance company, mutual ditch or irrigation company, mutual or co-operative telephone company, or like organization of a purely local character, the income of which consists solely of assessments, dues, and fees collected from members for the sole purpose of meeting its expenses;

169 Eleventh. Farmers', fruit growers', or like associations, organized and operated as a sales agent for the purpose of marketing the products of its members and turning back to them the proceeds of sales, less the necessary selling expenses, on the basis of the quantity of produce furnished by them;

170 Twelfth. Corporation or association organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt from the tax imposed by this title; or

171 Thirteenth. Federal land banks and national farm-loan associations as provided in section twenty-six of the Act approved July seventeenth, nineteen hundred and sixteen, entitled "An Act to provide capital for agricultural development, to create standard forms of investment based upon farm mortgage, to equalize rates of interest upon farm loans, to furnish a market for United States bonds, to create Government depositaries and financial agents for the United States, and for other purposes."

172 Fourteenth. Joint stock land banks as to income derived from bonds or debentures of other joint stock land banks or any Federal land bank belonging to such joint stock land bank.

173 (b) There shall not be taxed under this title any income derived from any public utility or from the exercise of any essential governmental function accruing to any State, Territory, or the District of Columbia, or any political sub-division of a State or Territory, nor any income accruing to the government of the Philippine Islands or Porto Rico, or of any political sub-division of the Philippine Islands or Porto Rico:

174 Provided, That whenever any State, Territory, or the District

of Columbia, or any political sub-division of a State or Territory, has, prior to the passage of this title, entered in good faith into a contract with any person or corporation, the object and purpose of which is to acquire, construct, operate, or maintain a public utility, no tax shall be levied under the provisions of this title upon the income derived from the operation of such public utility, so far as the payment thereof will impose a loss or burden upon such State, Territory, or the District of Columbia, or a political sub-division of a State or Territory;

175 but this provision is not intended to confer upon such person or corporation any financial gain or exemption or to relieve such person or corporation from the payment of a tax as provided for in this title upon the part or portion of the said income to which such person or corporation shall be entitled under such contract.

Deductions

176 Sec. 12. (a) In the case of a corporation, joint-stock company or association, or insurance company, organized in the United States, such net income shall be ascertained by deducting from the gross amount of its income received within the year from all sources—

177 First. All the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties, including rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity.

178 Second. All losses actually sustained and charged off within the year and not compensated by insurance or otherwise, including a reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business or trade;

179 (a) in the case of oil and gas wells a reasonable allowance for actual reduction in flow and production to be ascertained not by the flush flow, but by the settled production or regular flow;

180 (b) in the case of mines a reasonable allowance for depletion thereof not to exceed the market value in the mine of the product thereof which has been mined and sold during the year for which the return and computation are made,

181 such reasonable allowance to be made in the case of both (a) and (b) under rules and regulations to be prescribed by the Secretary of the Treasury:

182 Provided, That when the allowance authorized in (a) and (b) shall equal the capital originally invested, or in case of purchase made prior to March first, nineteen hundred and thirteen, the fair market value as of that date, no further allowance shall be made; and

183 (c) in the case of insurance companies, the net addition, if any, required by law to be made within the year to reserve funds and the sums other than dividends paid within the year on policy and annuity contracts:

184 Provided, That no deduction shall be allowed for any amount paid out for new buildings, permanent improvements, or betterments made to increase the value of any property or estate,

185 and no deduction shall be made for any amount of expense of restoring property or making good the exhaustion thereof for which an allowance is or has been made:

186 Provided further, That mutual fire and mutual employers' liability and mutual workmen's compensation and mutual casualty insurance companies requiring their members to make premium deposits to provide for losses and expenses shall not return as income any portion of the premium deposits returned to their policyholders, but shall return as taxable income all income received by them from all other sources plus such portions of the premium deposits as are retained by the companies for purposes

other than the payment of losses and expenses and re-insurance reserves:

187 Provided further, That mutual marine insurance companies shall include in their return of gross income gross premiums collected and received by them less amounts paid for reinsurance, but shall be entitled to include in deductions from gross income amounts repaid to policy-holders on account of premiums previously paid by them and interest paid upon such amounts between the ascertainment thereof and the payment thereof,

188 and life insurance companies shall not include as income in any year such portion of any actual premium received from any individual policyholder as shall have been paid back or credited to such individual policyholder or treated as an abatement of premium of such individual policyholder within such year;

189 Third. The amount of interest paid within the year on its indebtedness (except on indebtedness incurred for the purchase of obligations or securities the interest upon which is exempt from taxation as income under this title) to an amount of such indebtedness not in excess of the sum of (a) the entire amount of the paid-up capital stock outstanding at the close of the year, or, if no capital stock, the entire amount of capital employed in the business at the close of the year, and (b) one-half of its interest-bearing indebtedness then outstanding:

190 Provided, That for the purpose of this title preferred capital stock shall not be considered interest-bearing indebtedness, and interest or dividends paid upon this stock shall not be deductible from gross income:

191 Provided further, That in cases wherein shares of capital stock are issued without par or nominal value, the amount of paid-up capital stock, within the meaning of this section, as represented by such shares, will be the amount of cash, or its equivalent, paid or transferred to the corporation as a consideration for such shares:

192 Provided further, That in the case of indebtedness wholly secured by property collateral, tangible or intangible, the subject of sale or hypothecation in the ordinary business of such corporation, joint-stock company or association as a dealer only in the property constituting such collateral, or in loaning the funds thereby procured, the total interest paid by such corporation, company, or association within the year on any such indebtedness may be deducted as a part of its expenses of doing business, but interest on such indebtedness shall only be deductible on an amount of such indebtedness not in excess of the actual value of such property collateral:

193 Provided further, That in the case of bonds or other indebtedness, which have been issued with a guaranty that the interest payable thereon shall be free from taxation, no deduction for the payment of the tax herein imposed, or any other tax paid pursuant to such guaranty, shall be allowed;

194 and in the case of a bank, banking association, loan or trust company, interest paid within the year on deposits or on moneys received for investment and secured by interest-bearing certificates of indebtedness issued by such bank, banking association, loan or trust company shall be deducted;

195 Fourth. Taxes paid within the year imposed by the authority of the United States (except income and excess profits taxes), or of its Territories, or possessions, or any foreign country, or by the authority of any State, county, school district, or municipality, or other taxing subdivision of any State, not including those assessed against local benefits.

196 (b) In the case of a corporation, joint-stock company or association, or insurance company, organized, authorized, or existing under the laws of any foreign country, such net income shall be ascertained by deducting from the gross amount of its income received within the year from all sources within the United States—

197 First. All the ordinary and necessary expenses paid within the year out of earnings in the maintenance and operation of its business and property within the United States, including rentals or other payments

required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity.

198 Second. All losses actually sustained within the year in business or trade conducted by it within the United States and not compensated by insurance or otherwise, including a reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business or trade;

199 (a) and in the case of oil and gas wells a reasonable allowance for actual reduction in flow and production to be ascertained not by the flush flow, but by the settled production or regular flow,

200 (b) In the case of mines a reasonable allowance for depletion thereof not to exceed the market value in the mine of the product thereof which has been mined and sold during the year for which the return and computation are made,

201 such reasonable allowance to be made in the case of both (a) and (b) under rules and regulations to be prescribed by the Secretary of the Treasury:

202 Provided, That when the allowance authorized in (a) and (b) shall equal the capital originally invested, or in case of purchase made prior to March first, nineteen hundred and thirteen, the fair market value as of that date, no further allowance shall be made; and

203 (c) in the case of insurance companies, the net addition, if any, required by law to be made within the year to reserve funds and the sums other than dividends paid within the year on policy and annuity contracts:

204 Provided, That no deduction shall be allowed for any amount paid out for new buildings, permanent improvements, or betterments, made to increase the value of any property or estate,

205 and no deduction shall be made for any amounts of expense of restoring property or making good the exhaustion thereof for which an allowance is or has been made:

206 Provided, further, That mutual fire and mutual employers' liability and mutual workmen's compensation and mutual casualty insurance companies requiring their members to make premium deposits to provide for losses and expenses shall not return as income any portion of the premium deposits returned to their policy-holders, but shall return as taxable income all income received by them from all other sources plus such portions of the premium deposits as are retained by the companies for purposes other than the payment of losses and expenses and reinsurance reserves:

207 Provided further, That mutual marine insurance companies shall include in their return of gross income gross premiums collected and received by them less amounts paid for reinsurance, but shall be entitled to include in deductions from gross income amounts repaid to policy-holders on account of premiums previously paid by them, and interest paid upon such amounts between the ascertainment thereof and the payment thereof,

208 and life insurance companies shall not include as income in any year such portion of any actual premium received from any individual policy-holder as shall have been paid back or credited to such individual policy-holder, or treated as an abatement of premium of such individual policy-holder, within such year;

209 Third. The amount of interest paid within the year on its indebtedness (except on indebtedness incurred for the purchase of obligations or securities the interest upon which is exempt from taxation as income under this title) to an amount of such indebtedness not in excess of the proportion of the sum of (a) the entire amount of the paid-up capital stock outstanding at the close of the year, or, if no capital stock, the entire amount of the capital employed in the business at the close of the year, and (b) one-half of its interest-bearing indebtedness then outstanding,

which the gross amount of its income for the year from business transacted and capital invested within the United States bears to the gross amount of its income derived from all sources within and without the United States:

210 Provided, That in the case of bonds or other indebtedness which have been issued with a guaranty that the interest payable thereon shall be free from taxation, no deduction for the payment of the tax herein imposed or any other tax paid pursuant to such guaranty shall be allowed;

211 and in case of a bank, banking association, loan or trust company, or branch thereof, interest paid within the year on deposits by or on moneys received for investment from either citizens or residents of the United States and secured by interest-bearing certificates of indebtedness issued by such bank, banking association, loan or trust company, or branch thereof;

212 Fourth. Taxes paid within the year imposed by the authority of the United States (except income and excess profits taxes), or of its Territories, or possessions, or by the authority of any State, county, school district, or municipality, or other taxing subdivision of any State, paid within the United States, not including those assessed against local benefits.

213 (c) In the case of assessment insurance companies, whether domestic or foreign, the actual deposit of sums with State or Territorial officers, pursuant to law, as additions to guarantee or reserve funds shall be treated as being payments required by law to reserve funds.

Returns

214 Sec. 13. (a) The tax shall be computed upon the net income, as thus ascertained, received within each preceding calendar year ending December thirty-first:

215 Provided, That any corporation, joint-stock company or association, or insurance company, subject to this tax, may designate the last day of any month in the year as the day of the closing of its fiscal year and shall be entitled to have the tax payable by it computed upon the basis of the net income ascertained as herein provided for the year ending on the day so designated in the year preceding the date of assessment instead of upon the basis of the net income for the calendar year preceding the date of assessment;

216 and it shall give notice of the day it has thus designated as the closing of its fiscal year to the collector of the district in which its principal business office is located at any time not less than thirty days prior to the first day of March of the year in which its return would be filed if made upon the basis of the calendar year;

217 (b) Every corporation, joint-stock company or association, or insurance company, subject to the tax herein imposed, shall, on or before the first day of March, nineteen hundred and seventeen, and the first day of March in each year thereafter, or, if it has designated a fiscal year for the computation of its tax, then within sixty days after the close of such fiscal year ending prior to December thirty-first, nineteen hundred and sixteen, and the close of each such fiscal year thereafter,

218 render a true and accurate return of its annual net income in the manner and form to be prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, and containing such facts, data, and information as are appropriate and in the opinion of the commissioner necessary to determine the correctness of the net income returned and to carry out the provisions of this title.

219 The return shall be sworn to by the president, vice-president, or other principal officer, and by the treasurer or assistant treasurer.

220 The return shall be made to the collector of the district in which is located the principal office of the corporation, company, or association, where are kept its books of account and other data from which the return is prepared,

221 or in the case of a foreign corporation, company, or association, to the collector of the district in which is located its principal place of business in the United States,

222 or if it have no principal place of business, office, or agency in the United States, then to the collector of internal revenue at Baltimore, Maryland.

223 All such returns shall as received be transmitted forthwith by the collector to the Commissioner of Internal Revenue;

224 (c) In cases wherein receivers, trustees in bankruptcy, or assignees are operating the property or business of corporations, joint-stock companies or associations, or insurance companies, subject to tax imposed by this title, such receivers, trustees, or assignees shall make returns of net income as and for such corporations, joint-stock companies or associations, and insurance companies, in the same manner and form as such organizations are hereinbefore required to make returns, and any income tax due on the basis of such returns made by receivers, trustees, or assignees shall be assessed and collected in the same manner as if assessed directly against the organizations of whose businesses or properties they have custody and control;

225 (d) A corporation, joint-stock company or association, or insurance company, keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect its income, may, subject to regulations made by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, make its return upon the basis upon which its accounts are kept, in which case the tax shall be computed upon its income as so returned;

226 (e) All the provisions of this title relating to the tax authorized and required to be deducted and withheld and paid to the officer of the United States Government authorized to receive the same from the income of nonresident alien individuals from sources within the United States shall be made applicable to the tax imposed by subdivision (a) of section ten upon incomes derived from interest upon bonds and mortgages or deeds of trust or similar obligations of domestic or other resident corporations, joint-stock companies or associations, and insurance companies by nonresident alien firms, copartnerships, companies, corporations, joint-stock companies or associations, and insurance companies, not engaged in business or trade within the United States and not having any office or place of business therein.

227 (f) Likewise, all the provisions of this title relating to the tax authorized and required to be deducted and withheld and paid to the officer of the United States Government authorized to receive the same from the income of nonresident alien individuals from sources within the United States shall be made applicable to income derived from dividends upon the capital stock or from net earnings of domestic or other resident corporations, joint-stock companies or associations, and insurance companies, by nonresident alien companies, corporations, joint-stock companies or associations, and insurance companies not engaged in business or trade within the United States and not having any office or place of business therein.

Assessment and Administration

228 Sec. 14. (a) All assessments shall be made and the several corporations, joint-stock companies or associations, and insurance companies shall be notified of the amount for which they are respectively liable on or before the first day of June of each successive year, and said assessment shall be paid on or before the fifteenth day of June:

229 Provided, That every corporation, joint-stock company or association, and insurance company, computing taxes upon the income of the fiscal year which it may designate in the manner hereinbefore provided, shall pay the taxes due under its assessment within one hundred and five days after the date upon which it is required to file its list or return of income for assessment;

230 except in cases of refusal or neglect to make such return, and in cases of erroneous, false, or fraudulent returns, in which cases the Commissioner of Internal Revenue shall, upon the discovery thereof, at any time

within three years after said return is due, make a return upon information obtained as provided for in this title or by existing law; and the assessment made by the Commissioner of Internal Revenue thereon shall be paid by such corporation, joint-stock company or association, or insurance company immediately upon notification of the amount of such assessment;

231 and to any sum or sums due and unpaid after the fifteenth day of June in any year, or after one hundred and five days from the date on which the return of income is required to be made by the taxpayer, and after ten days' notice and demand thereof by the collector, there shall be added the sum of five per centum on the amount of tax unpaid and interest at the rate of one per centum per month upon said tax from the time the same becomes due:

232 Provided, That upon the examination of any return of income made pursuant to this title, the act of August fifth, nineteen hundred and nine, entitled "An act to provide revenue, equalize duties and encourage the industries of the United States, and for other purposes," and the act of October third, nineteen hundred and thirteen, entitled, "An act to reduce tariff duties and to provide revenue for the Government, and for other purposes," if it shall appear that amounts of tax have been paid in excess of those properly due, the taxpayer shall be permitted to present a claim for refund thereof notwithstanding the provisions of section thirty-two hundred and twenty-eight of the Revised Statutes;

233 (b) When the assessment shall be made, as provided in this title, the returns, together with any corrections thereof which may have been made by the commissioner, shall be filed in the office of the Commissioner of Internal Revenue and shall constitute public records and be open to inspection as such:

234 Provided, That any and all such returns shall be open to inspection only upon the order of the President, under rules and regulations to be prescribed by the Secretary of the Treasury and approved by the President:

235 Provided further, That the proper officers of any State imposing a general income tax may, upon the request of the governor thereof, have access to said returns or to an abstract thereof, showing the name and income of each such corporation, joint-stock company or association, or insurance company, at such times and in such manner as the Secretary of the Treasury may prescribe;

236 (c) If any of the corporations, joint-stock companies or associations, or insurance companies aforesaid shall refuse or neglect to make a return at the time or times hereinbefore specified in each year, or shall render a false or fraudulent return, such corporation, joint-stock company or association, or insurance company shall be liable to a penalty of not exceeding $10,000:

237 Provided, That the Commissioner of Internal Revenue shall have authority, in the case of either corporations or individuals to grant a reasonable extension of time in meritorious cases, as he may deem proper.

238 (d) That section thirty-two hundred and twenty-five of the Revised Statutes of the United States be, and the same is hereby, amended so as to read as follows:

239 "Sec. 3225. When a second assessment is made in case of any list, statement, or return, which in the opinion of the collector or deputy collector was false or fraudulent, or contained any understatement or undervaluation, no tax collected under such assessment shall be recovered by any suit unless it is proved that the said list, statement, or return was not false nor fraudulent and did not contain any understatement or undervaluation; but this section shall not apply to statements or returns made or to be made in good faith under the laws of the United States regarding annual depreciation of oil or gas wells and mines."

Part III.—General Administrative Provisions

240 Sec. 15. That the word "State" or "United States" when used in this title shall be construed to include any Territory, the District of Columbia, Porto Rico, and the Philippine Islands, when such construction is necessary to carry out its provisions.

241 Sec. 16. That sections thirty-one hundred and sixty-seven, thirty-one hundred and seventy-two, thirty-one hundred and seventy-three, and thirty-one hundred and seventy-six of the Revised Statutes of the United States as amended are hereby amended so as to read as follows:

242 "Sec. 3167. It shall be unlawful for any collector, deputy collector, agent, clerk, or other officer or employee of the United States to divulge or to make known in any manner whatever not provided by law to any person the operations, style of work, or apparatus of any manufacturer or producer visited by him in the discharge of his official duties, or the amount or source of income, profits, losses, expenditures, or any particular thereof, set forth or disclosed in any income return, or to permit any income return or copy thereof or any book containing any abstract or particulars thereof to be seen or examined by any person except as provided by law;

243 and it shall be unlawful for any person to print or publish in any manner whatever not provided by law any income return or any part thereof or source of income, profits, losses, or expenditures appearing in any income return;

244 and any offense against the foregoing provision shall be a misdemeanor and be punished by a fine not exceeding $1,000 or by imprisonment not exceeding one year, or both, at the discretion of the court;

245 and if the offender be an officer or employee of the United States he shall be dismissed from office or discharged from employment.

246 "Sec. 3172. Every collector shall, from time to time, cause his deputies to proceed through every part of his district and inquire after and concerning all persons therein who are liable to pay any internal-revenue tax, and all persons owning or having the care and management of any objects liable to pay any tax, and to make a list of such persons and enumerate said objects.

247 "Sec. 3173. It shall be the duty of any person, partnership, firm, association, or corporation, made liable to any duty, special tax, or other tax imposed by law, when not otherwise provided for, (1) in case of a special tax, on or before the thirty-first day of July in each year, (2) in case of income tax on or before the first day of March in each year, or on or before the last day of the sixty-day period next following the closing date of the fiscal year for which it makes a return of its income, and (3) in other cases before the day on which the taxes accrue, to make a list or return, verified by oath, to the collector or a deputy collector of the district where located, of the articles or objects, including the amount of annual income charged with a duty or tax, the quantity of goods, wares, and merchandise, made or sold and charged with a tax, the several rates and aggregate amount, according to the forms and regulations to be prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, for which such person, partnership, firm, association, or corporation is liable:

248 Provided, That if any person liable to pay any duty or tax, or owning, possessing, or having the care or management of property, goods, wares, and merchandise, articles or objects liable to pay any duty, tax, or license, shall fail to make and exhibit a list or return required by law, but shall consent to disclose the particulars of any and all the property, goods, wares, and merchandise, articles, and objects liable to pay any duty or tax, or any business or occupation liable to pay any tax as aforesaid, then, and in that case, it shall be the duty of the collector or deputy collector to make such list or return, which, being distinctly read, consented to, and signed and verified by oath by the person so owning, possessing, or having the care and management as

aforesaid, may be received as the list of such person:

249 Provided further, That in case no annual list or return has been rendered by such person to the collector or deputy collector as required by law, and the person shall be absent from his or her residence or place of business at the time the collector or a deputy collector shall call for the annual list or return, it shall be the duty of such collector or deputy collector to leave at such place of residence or business, with some one of suitable age and discretion, if such be present, otherwise to deposit in the nearest post office, a note or memorandum addressed to such person, requiring him or her to render to such collector or deputy collector the list or return required by law within ten days from the date of such note or memorandum, verified by oath.

250 And if any person, on being notified or required as aforesaid, shall refuse or neglect to render such list or return within the time required as aforesaid, or whenever any person who is required to deliver a monthly or other return of objects subject to tax fails to do so at the time required, or delivers any return which, in the opinion of the collector, is erroneous, false, or fraudulent, or contains any undervaluation or understatement, or refuses to allow any regularly authorized Government officer to examine the books of such person, firm, or corporation, it shall be lawful for the collector to summon such person, or any other person having possession, custody, or care of books of account containing entries relating to the business of such person, or any other person he may deem proper, to appear before him and produce such books at a time and place named in the summons, and to give testimony or answer interrogatories, under oath, respecting any objects or income liable to tax or the returns thereof.

251 The collector may summon any person residing or found within the State or Territory in which his district lies; and when the person intended to be summoned does not reside and can not be found within such State or Territory, he may enter any collection district where such person may be found and there make the examination herein authorized. And to this end he may there exercise all the authority which he might lawfully exercise in the district for which he was commissioned:

252 Provided, That 'person,' as used in this section, shall be construed to include any corporation, joint-stock company or association, or insurance company when such construction is necessary to carry out its provisions.

253 "Sec. 3176. If any person, corporation, company, or association fails to make and file a return or list at the time prescribed by law, or makes, willfully or otherwise, a false or fraudulent return or list, the collector or deputy collector shall make the return or list from his own knowledge and from such information as he can obtain through testimony or otherwise.

254 Any return or list so made and subscribed by a collector or deputy collector shall be prima facie good and sufficient for all legal purposes.

255 "If the failure to file a return or list is due to sickness or absence the collector may allow such further time, not exceeding thirty days, for making and filing the return or list as he deems proper.

256 "The Commissioner of Internal Revenue shall assess all taxes, other than stamp taxes, as to which returns or lists are so made by a collector or deputy collector.

257 In case of any failure to make and file a return or list within the time prescribed by law or by the collector, the Commissioner of Internal Revenue shall add to the tax fifty per centum of its amount

258 except that, when a return is voluntarily and without notice from the collector filed after such time and it is shown that the failure to file it was due to a reasonable cause and not to willful neglect, no such addition shall be made to the tax.

259 In case a false or fraudulent return or list is willfully made, the Commissioner of Internal Revenue shall add to the tax one hundred per centum of its amount.

260 "The amount so added to any tax shall be collected at the same time and in the same manner and as part of the tax unless the tax has been paid before the discovery of the neglect, falsity, or fraud, in which case the amount so added shall be collected in the same manner as the tax."

261 Sec. 17. That it shall be the duty of every collector of internal revenue, to whom any payment of any taxes is made under the provisions of this title, to give to the person making such payment a full written or printed receipt, expressing the amount paid and the particular account for which such payment was made;

262 and whenever such payment is made such collector shall, if required, give a separate receipt for each tax paid by any debtor, on account of payments made to or to be made by him to separate creditors in such form that such debtor can conveniently produce the same separately to his several creditors in satisfaction of their respective demands to the amounts specified in such receipts;

263 and such receipts shall be sufficient evidence in favor of such debtor to justify him in withholding the amount therein expressed from his next payment to his creditors;

264 but such creditor may, upon giving to his debtor a full written receipt, acknowledging the payment to him of whatever sum may be actually paid, and accepting the amount of tax paid as aforesaid (specifying the same) as a further satisfaction of the debt to that amount, require the surrender to him of such collector's receipt.

265 Sec. 18. That any person, corporation, partnership, association, or insurance company, liable to pay the tax, to make a return or to supply information required under this title, who refuses or neglects to pay such tax, to make such return or to supply such information at the time or times herein specified in each year, shall be liable, except as otherwise specially provided in this title, to a penalty of not less than $20 nor more than $1,000.

266 Any individual or any officer of any corporation, partnership, association, or insurance company, required by law to make, render, sign, or verify any return or to supply any information, who makes any false or fraudulent return or statement with intent to defeat or evade the assessment required by this title to be made, shall be guilty of a misdemeanor, and shall be fined not exceeding $2,000 or be imprisoned not exceeding one year, or both, in the discretion of the court, with the costs of prosecution:

267 Provided, That where any tax heretofore due and payable has been duly paid by the taxpayer, it shall not be re-collected from any withholding agent required to retain it at its source, nor shall any penalty be imposed or collected in such cases from the taxpayer, or such withholding agent whose duty it was to retain it, for failure to return or pay the same, unless such failure was fraudulent and for the purpose of evading payment.

268 Sec. 19. The collector or deputy collector shall require every return to be verified by the oath of the party rendering it. If the collector or deputy collector have reason to believe that the amount of any income returned is understated, he shall give due notice to the person making the return to show cause why the amount of the return should not be increased, and upon proof of the amount understated may increase the same accordingly.

269 Such person may furnish sworn testimony to prove any relevant facts, and, if dissatisfied with the decision of the collector, may appeal to the Commissioner of Internal Revenue for his decision under such rules of procedure as may be prescribed by regulation.

270 Sec. 20. That jurisdiction is hereby conferred upon the district courts of the United States for the district within which any person summoned under this title to appear to testify or to produce books shall reside, to compel such attendance, production of books, and testimony by appropriate process.

271 Sec. 21. That the preparation and publication of statistics reasonably available with respect to the operation of the income tax law and containing classifications of taxpayers and of income, the amounts allowed as deductions and exemptions, and any other facts deemed pertinent and valuable, shall be made annually by the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury.

272 Sec. 22. That all administrative, special, and general provisions of law, including the laws in relation to the assessment, remission, collection, and refund of internal-revenue taxes not heretofore specifically repealed and not inconsistent with the provisions of this title, are hereby extended and made applicable to all the provisions of this title and to the tax herein imposed.

273 Sec. 23. That the provisions of this title shall extend to Porto Rico and the Philippine Islands.

274 Provided, That the administration of the law and the collection of the taxes imposed in Porto Rico and the Philippine Islands shall be by the appropriate internal-revenue officers of those governments, and all revenues collected in Porto Rico and the Philippine Islands, thereunder shall accrue intact to the general governments thereof, respectively:

275 Provided further, That the jurisdiction in this title conferred upon the district courts of the United States shall, so far as the Philippine Islands are concerned, be vested in the courts of the first instance of said islands:

276 And provided further, That nothing in this title shall be held to exclude from the computation of the net income the compensation paid any official by the governments of the District of Columbia, Porto Rico, and the Philippine Islands, or the political sub-divisions thereof.

277 Sec. 24. That Section II of the Act approved October third, nineteen hundred and thirteen, entitled "An Act to reduce tariff duties and to provide revenue for the Government, and for other purposes," is hereby repealed, except as herein otherwise provided, and except that it shall remain in force for the assessment and collection of all taxes which have accrued thereunder, and for the imposition and collection of all penalties or forfeitures which have accrued or may accrue in relation to any of such taxes, and except that the unexpended balance of any appropriation heretofore made and now available for the administration of such section or any provision thereof shall be available for the administration of this title or the corresponding provision thereof.

278 Sec. 25. That income on which has been assessed the tax imposed by Section II of the Act entitled "An Act to reduce tariff duties and to provide revenue for the Government, and for other purposes," approved October third, nineteen hundred and thirteen, shall not be considered as income within the meaning of this title:

279 Sec. 26. Every corporation, joint-stock company or association, or insurance company subject to the tax herein imposed, when required by the Commissioner of Internal Revenue,

280 shall render a correct return, duly verified under oath, of its payments of dividends, whether made in cash or its equivalent or in stock,

281 including the names and addresses of stockholders and the number of shares owned by each,

282 and the tax years and the applicable amounts in which such dividends were earned,

283 in such form and manner as may be prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury.

284 Sec. 27. That every person, corporation, partnership, or association, doing business as a broker on any exchange or board of trade or other similar place of business

285 shall, when required by the Commissioner of Internal Revenue, render a correct return duly verified under oath, under such rules and regu-

lations as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may prescribe,

286 showing the names of customers for whom such person, corporation, partnership, or association has transacted any business,

287 with such details as to the profits, losses, or other information which the commissioner may require, as to each of such customers,

288 as will enable the Commissioner of Internal Revenue to determine whether all income tax due on profits or gains of such customers has been paid.

289 Sec. 28. That all persons, corporations, partnerships, associations, and insurance companies, in whatever capacity acting, including

290 lessees or mortgagors of real or personal property,

291 trustees acting in any trust capacity,

292 executors, administrators, receivers, conservators,

293 and employers,

294 making payment to another person, corporation, partnership, association, or insurance company,

295 of interest, rent, salaries, wages, premiums, annuities, compensation, remuneration, emoluments, or other fixed or determinable gains, profits, and income (other than payments described in sections twenty-six and twenty-seven),

296 of $800 or more in any taxable year,

297 or, in the case of such payments made by the United States, the officers or employees of the United States having information as to such payments and required to make returns in regard thereto by the regulations hereinafter provided for,

298 are hereby authorized and required to render a true and accurate return to the Commissioner of Internal Revenue, under such rules and regulations and in such form and manner as may be prescribed by him, with the approval of the Secretary of the Treasury,

299 setting forth the amount of such gains, profits, and income,

300 and the name and address of the recipient of such payment:

301 Provided, That such returns shall be required, regardless of amounts, in the case of payments of interest upon bonds and mortgages or deeds of trust or other similar obligations of corporations, joint-stock companies, associations, and insurance companies, and in the case of collections of items (not payable in the United States) of interest upon the bonds of foreign countries and interest from the bonds and dividends from the stock of foreign corporations by persons, corporations, partnerships, or associations, undertaking as a matter of business or for profit the collection of foreign payments of such interest or dividends by means of coupons, checks, or bills of exchange.

302 When necessary to make effective the provisions of this section the name and address of the recipient of income shall be furnished upon demand of the person, corporation, partnership, association, or insurance company paying the income.

303 The provisions of this section shall apply to the calendar year nineteen hundred and seventeen and each calendar year thereafter, but shall not apply to the payment of interest on obligations of the United States.

304 Sec. 29. That in assessing income tax the net income embraced in the return shall also be credited with the amount of any excess profits tax imposed by Act of Congress and assessed for the same calendar or fiscal year upon the taxpayer and, in the case of a member of a partnership, with his proportionate share of such excess profits tax imposed upon the partnership.

305 Sec. 30. That nothing in section II of the Act approved October third, nineteen hundred and thirteen, entitled 'An Act to reduce tariff duties and to provide revenue for the Government, and for other purposes,' or in this title, shall be construed as taxing the income of foreign governments received from investments in the United States in stocks, bonds, or other domestic securities, owned by such foreign governments, or from interest

on deposits in banks in the United States of moneys belonging to foreign governments.

306 Sec. 31. (a) That the term 'dividends' as used in this title shall be held to mean any distribution made or ordered to be made by a corporation, joint-stock company, association, or insurance company, out of its earnings or profits accrued since March first, nineteen hundred and thirteen, and payable to its shareholders, whether in cash or in stock of the corporation, joint-stock company, association, or insurance company, which stock dividend shall be considered income, to the amount of the earnings or profits so distributed.

307 (b) Any distribution made to the share-holders or members of a corporation, joint-stock company, or association, or insurance company, in the year nineteen hundred and seventeen, or subsequent tax years, shall be deemed to have been made from the most recently accumulated undivided profits or surplus, and shall constitute a part of the annual income of the distributee for the year in which received, and shall be taxed to the distributee at the rates prescribed by law for the years in which such profits or surplus were accumulated by the corporation, joint-stock company, association, or insurance company,

308 but nothing herein shall be construed as taxing any earnings or profits accrued prior to March first, nineteen hundred and thirteen, but such earnings or profits may be distributed in stock dividends or otherwise, exempt from the tax, after the distribution of earnings and profits accrued since March first, nineteen hundred and thirteen, has been made.

309 This subdivision shall not apply to any distribution made prior to August sixth, nineteen hundred and seventeen, out of earnings or profits accrued prior to March first, nineteen hundred and thirteen.

310 Sec. 32. That premiums paid on life insurance policies covering the lives of officers, employees, or those financially interested in any trade or business conducted by an individual, partnership, corporation, joint-stock company or association, or insurance company, shall not be deducted in computing the net income of such individual, corporation, joint-stock company or association, or insurance company, or in computing the profits of such partnership for the purposes of subdivision (e) of section nine.

311 That any amount heretofore withheld by any withholding agent as required by Title I of such Act of September eighth, nineteen hundred and sixteen, on account of the tax imposed upon the income of any individual, a citizen or resident of the United States, for the calendar year nineteen hundred and seventeen, except in the cases covered by subdivision (c) of section nine of such Act, as amended by this Act, shall be released and paid over to such individual, and the entire tax upon the income of such individual for such year shall be assessed and collected in the manner prescribed by such Act as amended by this Act.

THE WAR INCOME TAX.

Title I of the Act of October 3, 1917.

(The taxes imposed by this Title are in addition to those imposed by the Act of September 8, 1916, as amended by other provisions of the Act of October 3, 1917.)

1 Section 1. That during the present war

2 in addition to the normal tax imposed by subdivision (a) of section one of the Act entitled "An Act to increase the revenue, and for other purposes,"

approved September eighth, nineteen hundred and sixteen,
3 there shall be levied, assessed, collected, and paid
4 a like normal tax of two per centum upon the income of every
5 individual, a citizen or resident of the United States,
6 received in the calendar year nineteen hundred and seventeen and every calendar year thereafter.

7 Sec. 2. That during the present war
8 in addition to the additional tax imposed by subdivision (b) of section one of such Act of September eighth, nineteen hundred and sixteen,
9 there shall be levied, assessed, collected, and paid
10 a like additional tax upon the income of
11 every individual received in the calendar year nineteen hundred and seventeen and every calendar year thereafter, as follows:

12 One per centum per annum upon the amount by which the total net income exceeds $5,000 and does not exceed $7,500;

13 Two per centum per annum upon the amount by which the total net income exceeds $7,500 and does not exceed $10,000;

14 Three per centum per annum upon the amount by which the total net income exceeds $10,000 and does not exceed $12,500;

15 Four per centum per annum upon the amount by which the total net income exceeds $12,500 and does not exceed $15,000;

16 Five per centum per annum upon the amount by which the total net income exceeds $15,000 and does not exceed $20,000;

17 Seven per centum per annum upon the amount by which the total net income exceeds $20,000 and does not exceed $40,000;

18 Ten per centum per annum upon the amount by which the total net income exceeds $40,000 and does not exceed $60,000;

19 Fourteen per centum per annum upon the amount by which the total net income exceeds $60,000 and does not exceed $80,000;

20 Eighteen per centum per annum upon the amount by which the total net income exceeds $80,000 and does not exceed $100,000;

21 Twenty-two per centum per annum upon the amount by which the total net income exceeds $100,000 and does not exceed $150,000;

22 Twenty-five per centum per annum upon the amount by which the total net income exceeds $150,000 and does not exceed $200,000;

23 Thirty per centum per annum upon the amount by which the total net income exceeds $200,000 and does not exceed $250,000;

24 Thirty-four per centum per annum upon the amount by which the total net income exceeds $250,000 and does not exceed $300,000;

25 Thirty-seven per centum per annum upon the amount by which the total net income exceeds $300,000 and does not exceed $500,000;

26 Forty per centum per annum upon the amount by which the total net income exceeds $500,000 an does not exceed $750,000.

27 Forty-five per centum per annum upon the amount by which the total net income exceeds $750,000 and does not exceed $1,000,000.

28 Fifty per centum per annum upon the amount by which the total net income exceeds $1,000,000.

29 Sec. 3. That the taxes imposed by sections one and two of this Act shall be computed, levied, assessed, collected, and paid upon the same basis and in the same manner as the similar taxes imposed by section one of such Act of September eighth, nineteen hundred and sixteen,
30 except that in the case of the tax imposed by section one of this Act
31 (a) the exemptions of $3,000 and $4,000 provided in section seven of such Act of September eighth, nineteen hundred and sixteen, as amended by this Act, shall be, respectively, $1,000 and $2,000, and
32 (b) the returns required under subdivisions (b) and (c) of section eight or such Act, as amended by this Act, shall be required in the case of net incomes of $1,000 or over, in the case of unmarried persons, and $2,000 or over in the case of married persons, instead of $3,000 or over; as therein provided, and
33 (c) the provisions of subdivision (c) of section nine of such Act, as amended by this Act, requiring the normal tax of individuals on income

derived from interest to be deducted and withheld at the source of the income shall not apply to the new two per centum normal tax prescribed in section one of this Act until on and after January first, nineteen hundred and eighteen, and thereafter only one two per centum normal tax shall be deducted and withheld at the source under the provisions of such subdivision (c), and any further normal tax for which the recipient of such income is liable under this Act or such Act of September eighth, nineteen hundred and sixteen, as amended by this Act, shall be paid by such recipient.

34 Sec. 4. That in addition to the tax imposed by subdivision (a) of section ten of such Act of September eighth, nineteen hundred and sixteen, as amended by this Act,

35 there shall be levied, assessed, collected, and paid

36 a like tax of four per centum

37 upon the income received in the calendar year nineteen hundred and seventeen and every calendar year thereafter,

38 by every corporation, joint-stock company or association, or insurance company, subject to the tax imposed by that subdivision of that section,

39 except that if it has fixed its own fiscal year, the tax imposed by this section for the fiscal year ending during the calendar year nineteen hundred and seventeen shall be levied, assessed, collected, and paid only on that proportion of its income for such fiscal year which the period between January first, nineteen hundred and seventeen, and the end of such fiscal year bears to the whole of such fiscal year.

40 The tax imposed by this section shall be computed, levied, assessed, collected, and paid upon the same incomes and in the same manner as the tax imposed by subdivision (a) of section ten of such Act of September eighth, nineteen hundred and sixteen, as amended by this Act,

41 except that for the purpose of the tax imposed by this section

42 the income embraced in a return of a corporation, joint-stock company or association, or insurance company,

43 shall be credited with the amount received as dividends upon the stock or from the net earnings of any other corporation, joint-stock company or association, or insurance company, which is taxable upon its net income as provided in this title.

44 Sec. 5. That the provisions of this title shall not extend to Porto Rico or the Philippine Islands, and the Porto Rican or Philippine Legislature shall have power by due enactment to amend, alter, modify, or repeal the income tax laws in force in Porto Rico or the Philippine Islands, respectively.

THE EXCESS PROFITS TAX

Title II of the Act of October 3, 1917.

Sec. 200. That when used in this title—

1 The term "corporation" includes joint-stock companies or associations and insurance companies;

2 The term "domestic" means created under the law of the United States, or of any state, territory, or district thereof,

3 and the term "foreign means created under the law of any other possession of the United States or of any foreign country or government;

4 The term "United States" means only the States, the Territories of Alaska and Hawaii, and the District of Columbia;

5 The term "taxable year" means the twelve months ending December thirty-first,

6 excepting in the case of a corporation or partnership which has fixed its own fiscal year, in which case it means such fiscal year.

7 The first taxable year shall be the year ending December thirty-first, nineteen hundred and seventeen,

8 except that in the case of a corporation or partnership which has fixed its own fiscal year, it shall be the fiscal year ending during the calendar year nineteen hundred and seventeen.

9 If a corporation or partnership, prior to March first, nineteen hundred and eighteen, makes a return covering its own fiscal year, and includes therein the income received during that part of the fiscal year falling within the calendar year nineteen hundred and sixteen, the tax for such taxable year shall be that proportion of the tax computed upon the net income during such full fiscal year which the time from January first, nineteen hundred and seventeen, to the end of such fiscal year bears to the full fiscal year; and

10 The term "prewar period" means the calendar years nineteen hundred and eleven, nineteen hundred and twelve, and nineteen hundred and thirteen, or,

11 if a corporation or partnership was not in existence or

12 an individual was not engaged in a trade or business

13 during the whole of such period,

14 then as many of such years during the whole of which the corporation or partnership was in existence or the individual was engaged in the trade or business.

15 The terms "trade" and "business" include professions and occupations.

16 The term "net income" means in the case of a foreign corporation or partnership or a nonresident alien individual, the net income received from sources within the United States.

17 Sec. 201. That in addition to the taxes under existing law and under this Act there shall be levied, assessed, collected, and paid for each taxable year upon the income of every corporation, partnership, or individual, a tax (hereinafter in this title referred to as the tax) equal to the following percentages of the net income:

18 Twenty per centum of the amount of the net income in excess of the deduction (determined as hereinafter provided) and not in excess of fifteen per centum of the invested capital for the taxable year;

19 Twenty-five per centum of the amount of the net income in excess of fifteen per centum and not in excess of twenty per centum of such capital;

20 Thirty-five per centum of the amount of the net income in excess of twenty per centum and not in excess of twenty-five per centum of such capital;

21 Forty-five per centum of the amount of the net income in excess of twenty-five per centum and not in excess of thirty-three per centum of such capital; and

22 Sixty per centum of the amount of the net income in excess of thirty-three per centum of such capital.

23 For the purpose of this title every corporation or partnership not exempt under the provisions of this section shall be deemed to be engaged in business, and

24 all the trades and businesses in which it is engaged shall be treated as a single trade or business, and

25 all its income from whatever source derived shall be deemed to be received from such trade or business.

26 This title shall apply to all trades or businesses of whatever description, whether continuously carried on or not, except—

27 (A) In the case of officers and employees under the United States, or any State, Territory, or the District of Columbia, or any local subdivision thereof, the compensation or fees received by them as such officers or employees;

28 (B) Corporations exempt from tax under the provisions of section eleven of Title I of such Act of September eighth, nineteen hundred and sixteen, as amended by this Act, and partnerships and individuals carrying on or doing the same business, or coming within the same description; and

29 (C) Incomes derived from the business of life, health, and accident insurance combined in one policy issued on the weekly premium payment plan.

30 Sec. 202. That the tax shall not be imposed in the case of the trade or business of a foreign corporation or partnership or a nonresident alien individual, the net income of which trade or business during the taxable year is less than $3,000.

31 Sec. 203. That for the purposes of this title the deduction shall be as follows, except as otherwise in this title provided—

32 (A) In the case of a domestic corporation, the sum of (1) an amount equal to the same percentage of the invested capital for the taxable year which the average amount of the annual net income of the trade or business during the prewar period was of the invested capital for the prewar period (but not less than seven or more than nine per centum of the invested capital for the taxable year), and (2) $3,000;

33 (B) In the case of a domestic partnership or of a citizen or resident of the United States, the sum of (1) an amount equal to the same percentage of the invested capital for the taxable year which the average amount of the annual net income of the trade or business during the prewar period was of the invested capital for the prewar period (but not less than seven or more than nine per centum of the invested capital for the taxable year), and (2) $6,000;

34 (C) In the case of a foreign corporation or partnership or of a nonresident alien individual, an amount ascertained in the same manner as provided in subdivisions (A) and (B), without any exemption of $3,000 or $6,000.

35 (D) If the Secretary of the Treasury is unable satisfactorily to determine the average amount of the annual net income of the trade or business during the prewar period, the deduction shall be determined in the same manner as provided in section two hundred and five.

36 Sec. 204. That if a corporation or partnership was not in existence, or
37 an individual was not engaged in the trade or business,
38 during the whole of any one calendar year during the prewar period,
39 the deduction shall be an amount equal to eight per centum of the invested capital for the taxable year, plus
40 in the case of a domestic corporation $3,000, and
41 in the case of a domestic partnership or a citizen or resident of the United States $6,000.

42 A trade or business carried on by a corporation, partnership, or individual, although formally organized or reorganized on or after January second, nineteen hundred and thirteen, which is substantially a continuation of a trade or business carried on prior to that date, shall, for the purpose of this title, be deemed to have been in existence prior to that date, and the net income and invested capital of its predecessor prior to that date shall be deemed to have been its net income and invested capital.

43 Sec. 205. (A) That if the Secretary of the Treasury, upon complaint finds either

44 (1) That during the prewar period a domestic corporation or partnership, or
45 a citizen or resident of the United States,
46 had no net income from the trade or business, or
47 (2) That during the prewar period the percentage, which the net income was of the invested capital, was low as compared with the percentage, which the net income during such period of representative corporations,

partnerships, and individuals, engaged in a like or similar trade or business, was of their invested capital,

48 then the deduction shall be the sum of

49 (1) an amount equal to the same percentage of its invested capital for the taxable year which the average deduction (determined in the same manner as provided in section two hundred and three, without including the $3,000 or $6,000 therein referred to) for such year of representative corporations, partnerships, or individuals, engaged in a like or similar trade or business, is of their average invested capital for such year, plus

50 (2) in the case of a domestic corporation $3,000, and in the case of a domestic partnership or a citizen or resident of the United States $6,000.

51 The percentage which the net income was of the invested capital in each trade or business shall be determined by the commissioner of internal revenue, in accordance with regulations prescribed by him, with the approval of the Secretary of the Treasury.

52 In the case of a corporation or partnership which has fixed its own fiscal year, the percentage determined for the calendar year ending during such fiscal year shall be used.

53 (B) The tax shall be assessed upon the basis of the deduction determined as provided in section two hundred and three,

54 but the taxpayer claiming the benefit of this section may at the time of making the return file a claim for abatement of the amount by which the tax so assessed exceeds a tax computed upon the basis of the deduction determined as provided in this section.

55 In such event, collection of the part of the tax covered by such claim for abatement shall not be made until the claim is decided, but if in the judgment of the commissioner of internal revenue, the interests of the United States would be jeopardized thereby he may require the claimant to give a bond in such amount and with such sureties as the commissioner may think wise to safeguard such interests, conditioned for the payment of any tax found to be due, with the interest thereon, and if such bond, satisfactory to the commissioner, is not given within such time as he prescribes, the full amount of tax assessed shall be collected and the amount overpaid, if any, shall upon final decision of the application be refunded as a tax erroneously or illegally collected.

56 Sec. 206. That for the purposes of this title the net income of a corporation shall be ascertained and returned

57 (A) for the calendar years nineteen hundred and eleven and nineteen hundred and twelve upon the same basis and in the same manner as provided in section thirty-eight of the Act entitled "An Act to Provide Revenue, equalize duties, and encourage the industries of the United States, and for other purposes," approved August fifth, nineteen hundred and nine, except that income taxes paid by it within the year imposed by the authority of the United States shall be included;

58 (B) for the calendar year nineteen hundred and thirteen upon the same basis and in the same manner as provided in section II of the Act entitled "An Act to reduce tariff duties and to provide revenue for the government, and for other purposes," approved October third, nineteen hundred and thirteen, except that income taxes paid by it within the year imposed by the authority of the United States shall be included, and except that the amounts received by it as dividends upon the stock or from the net earnings of other corporations, joint-stock companies or associations, or insurance companies, subject to the tax imposed by Section II of such Act of October third, nineteen hundred and thirteen, shall be deducted; and

59 (C) for the taxable year upon the same basis and in the same manner as provided in Title I of the Act entitled "An Act to increase the revenue, and for other purposes," approved September eighth, nineteen hundred and sixteen, as amended by this Act, except that the amounts received by it as dividends upon the stock or from the net earnings of other corporations, joint-stock companies or associations, or insurance companies, subject to the tax imposed by Title I of such Act of September eighth, nineteen hundred and sixteen, shall be deducted.

60 The net income of a partnership or individual shall be ascertained and returned for the calendar years nineteen hundred and eleven, nineteen hundred and twelve, and nineteen hundred and thirteen, and for the taxable year, upon the same basis and in the same manner as provided in Title I of such Act of September eighth, nineteen hundred and sixteen, as amended by this Act, except that the credit allowed by subdivision (B) of Section five of such Act shall be deducted.

61 There shall be allowed

62 (A) in the case of a domestic partnership the same deductions as allowed to individuals in subdivision (A) of section five of such Act of September eighth, nineteen hundred and sixteen, as amended by this Act; and

63 (B) in the case of a foreign partnership the same deductions as allowed to individuals in subdivision (A) of section six of such Act as amended by this Act.

64 Sec. 207. That as used in this title the term "invested capital" for any year means the average invested capital for the year, as defined and limited in this title, averaged monthly.

65 As used in this title "invested capital" does not include stocks, bonds (other than obligations of the United States), or other assets, the income from which is not subject to the tax imposed by this title, nor money or other property borrowed, and means, subject to the above limitations:

66 (A) In the case of a corporation or partnership:

67 (1) Actual cash paid in,

68 (2) the actual cash value of tangible property paid in other than cash, for stock or shares in such corporation or partnership, at the time of such payment (but in case such tangible property was paid in prior to January first, nineteen hundred and fourteen, the actual cash value of such property as of January first, nineteen hundred and fourteen, but in no case to exceed the par value of the original stock or shares specifically issued therefor), and

69 (3) paid in or earned surplus and undivided profits used or employed in the business, exclusive of undivided profits earned during the taxable year:

70 Provided, that

71 (a) the actual cash value of patents and copyrights paid in for stock or shares in such corporation or partnership, at the time of such payment, shall be included as invested capital, but not to exceed the par value of such stock or shares at the time of such payment, and

72 (b) the good will, trade marks, trade brands, the franchise of a corporation or partnership, or other intangible property, shall be included as invested capital if the corporation or partnership made payment bona fide therefor specifically as such in cash or tangible property, the value of such good will, trade-mark, trade brand, franchise, or intangible property, not to exceed the actual cash or actual cash value of the tangible property paid therefor at the time of such payment; but good will, trade-marks, trade brands, franchise of a corporation or partnership, or other intangible property, bona fide purchased, prior to March third, nineteen hundred and seventeen, for and with interests or shares in a partnership or for and with shares in the capital stock of a corporation (issued prior to March third, nineteen hundred and seventeen), in an amount not to exceed, on March third, nineteen hundred and seventeen, twenty per centum of the total interests or shares in the partnership or of the total shares of the actual stock of the corporation, shall be included in invested capital at a value not to exceed the actual cash value at the time of such purchase, and in case of issue of stock therefor not to exceed the par value of such stock;

73 (B) In the case of an individual,

74 (1) actual cash paid into the trade or business, and

75 (2) the actual cash value of tangible property paid into the trade or business, other than cash, at the time of such payment (but in case such tangible property was paid in prior to January first, nineteen hundred and

fourteen, the actual cash value of such property as of January first, nineteen hundred and fourteen), and

76 (3) the actual cash value of patents, copyrights, good will, trade marks, trade brands, franchises, or other intangible property, paid into the trade or business, at the time of such payment, if payment was made therefor specifically as such in cash or tangible property, not to exceed the actual cash or actual cash value of the tangible property bona fide paid therefor at the time of such payment.

77 In the case of a foreign corporation or partnership or of a nonresident alien individual the term "invested capital" means that proportion of the entire invested capital, as defined and limited in this title, which the net income from sources within the United States bears to the entire net income.

78 Sec. 208. That in case of the reorganization, consolidation, or change of ownership of a trade or business after March third, nineteen hundred and seventeen, if an interest or control in such trade or business of fifty per centum or more remains in control of the same persons, corporations, associations, partnerships, or any of them, then in ascertaining the invested capital of the trade or business no asset transferred or received from the prior trade or business shall be allowed a greater value than would have been allowed under this title in computing the invested capital of such prior trade or business if such asset had not been so transferred or received, unless such asset was paid for specifically as such, in cash or tangible property, and then not to exceed the actual cash or actual cash value of the tangible property paid therefor at the time of such payment.

79 Sec. 209. That in the case of a trade or business having no invested capital or not more than a nominal capital there shall be levied, assessed, collected, and paid, in addition to the taxes under existing law and under this Act, in lieu of the tax imposed by section two hundred and one, a tax equivalent to eight per centum of the net income of such trade or business, in excess of the following deductions:

80 In the case of a domestic corporation, $3,000, and

81 in the case of a domestic partnership, or a citizen or resident of the United States, $6,000,

82 in the case of all other trades or business, no deduction.

83 Sec. 210. That if the Secretary of the Treasury is unable in any case satisfactorily to determine the invested capital, the amount of the deduction shall be the sum of

84 (1) an amount equal to the same proportion of the net income of the trade or business received during the taxable year as the proportion which the average deduction (determined in the same manner as provided in section two hundred and three, without including the $3,000 or $6,000 therein referred to) for the same calendar year of representative corporations, partnerships, and individuals, engaged in a like or similar trade or business, bears to the total net income of the trade or business received by such corporations, partnerships, and individuals, plus

85 (2) in the case of a domestic corporation $3,000, and

86 in the case of a domestic partnership or a citizen or resident of the United States $6,000.

87 For the purpose of this section the proportion between the deduction and the net income in each trade or business shall be determined by the commissioner of internal revenue in accordance with regulations prescribed by him, with the approval of the Secretary of the Treasury.

88 In the case of a corporation or partnership which has fixed its own fiscal year, the proportion determined for the calendar year ending during such fiscal year shall be used.

89 Sec. 211. That every foreign partnership having a net income of $3,000 or more for the taxable year, and

90 every domestic partnership having a net income of $6,000 or more for the taxable year,

91 shall render a correct return of the income of the trade or business for the taxable year,

92 setting forth specifically the gross income for such year, and the deductions allowed in this title.

93 Such returns shall be rendered at the same time and in the same manner as is prescribed for income-tax returns under Title I of such Act of September eighth, nineteen hundred and sixteen, as amended by this Act.

94 Sec. 212. That all administrative, special, and general provisions of law, including the laws in relation to the assessment, remission, collection, and refund of internal-revenue taxes not heretofore specifically repealed, and not inconsistent with the provisions of this title, are hereby extended and made applicable to all the provisions of this title and to the tax herein imposed, and all provisions of Title I of such Act of September eighth, nineteen hundred and sixteen, as amended by this Act, relating to returns and payment of the tax therein imposed, including penalties, are hereby made applicable to the tax imposed by this title.

95 Sec. 213. That the commissioner of internal revenue, with the approval of the Secretary of the Treasury, shall make all necessary regulations for carrying out the provisions of this title, and

96 may require any corporation, partnership, or individual, subject to the provisions of this title, to furnish him with such facts, data, and information as in his judgment are necessary to collect the tax imposed by this title.

97 Sec. 214. That Title II (sections two hundred to two hundred and seven, inclusive) of the Act entitled "An Act to provide increased revenue to defray the expenses of the increased appropriations for the army and navy, and the extensions of fortifications, and for other purposes," approved March third, nineteen hundred and seventeen, is hereby repealed.

98 Any amount heretofore or hereafter paid on account of the tax imposed by such Title II, shall be credited toward the payment of the tax imposed by this title, and if the amount so paid exceeds the amount of such tax the excess shall be refunded as a tax erroneously or illegally collected.

99 Subdivision (1) of section three hundred and one of such Act of September eighth, nineteen hundred and sixteen, is hereby amended so that the rate of tax for the taxable year nineteen hundred and seventeen shall be ten per centum instead of twelve and one-half per centum, as therein provided.

100 Subdivision (2) of such section is hereby amended to read as follows:

"(2) This section shall cease to be of effect on and after January first, nineteen hundred and eighteen."

THE WAR TAX ON BEVERAGES

Title III of the Act of October 3, 1917.

Sec. 300.—That on and after the passage of this Act there shall be levied and collected on all distilled spirits in bond at that time or that have been or that may be then or thereafter produced in or imported into the United States, except such distilled spirits as are subject to the tax provided in section three hundred and three, in addition to the tax now imposed by law, a tax of $1.10 (or, if withdrawn for beverage purposes or for use in the manufacture or production of any article used or intended for use as a beverage, a tax of $2.10) on each proof gallon, or wine gallon when below proof, and a proportionate tax at a like rate on all fractional parts of such proof or wine gallon, to be paid by the

distiller or importer when withdrawn, and collected under the provisions of existing law.

That in addition to the tax under existing law there shall be levied and collected upon all perfumes hereafter imported into the United States containing distilled spirits, a tax of $1.10 per wine gallon, and a proportionate tax at a like rate on all fractional parts of such wine gallon. Such tax shall be collected by the collector of customs and deposited as internal-revenue collections, under such rules and regulations as the Commissioner of Internal Revenue, with the approval of the Secretary, may prescribe.

IMPORTATION OF SPIRITS.

That no distilled spirits produced after the passage of this Act shall be imported into the United States from any foreign country, or from the West Indian Islands recently acquired from Denmark (unless produced from products the growth of such islands, and not then into any State or Territory or District of the United States in which the manufacture or sale of intoxicating liquor is prohibited), or from Porto Rico, or the Philippine Islands. Under such rules, regulations, and bonds as the Secretary of the Treasury may prescribe, the provisions of this section shall not apply to distilled spirits imported for other than (1) beverage purposes or (2) use in the manufacture or production of any article used or intended for use as a beverage.

MOVEMENT OF SPIRITS.

Sec. 302. That at registered distilleries producing alcohol, or other high-proof spirits, packages may be filled with such spirits reduced to not less than one hundred proof from the receiving cisterns and tax paid without being entered into bonded warehouse. Such spirits may also be transferred from the receiving cisterns at such distilleries, by means of pipe lines, direct to storage tanks in the bonded warehouse and may be warehoused in such storage tanks. Such spirits may be also transferred in tanks or tank cars to general bonded warehouses for storage therein, either in storage tanks in such warehouses or in the tanks in which they were transferred. Such spirits may also be transferred after tax payment from receiving cisterns or warehouse storage tanks to tanks or tank cars and may be transported in such tanks or tank cars to the premises of rectifiers of spirits. The Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, is hereby empowered to prescribe all necessary regulations relating to the drawing off, transferring, gauging, storing and transporting of such spirits; the records to be kept and returns to be made; the size and kind of packages and tanks to be used; the marking, branding, numbering and stamping of such packages and tanks; the kinds of stamps, if any, to be used; and the time and manner of paying the tax; the kind of bond and the penal sum of same. The tax prescribed by law must be paid before such spirits are removed from the distillery premises, or from general bonded warehouse in the case of spirits transferred thereto, except as otherwise provided by law.

Under such regulations as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may prescribe, distilled spirits may hereafter be drawn from receiving cisterns and deposited in distillery warehouses without having affixed to the packages containing the same distillery warehouse stamps, and such packages, when so deposited in warehouse, may be withdrawn therefrom on the original gauge where the same have remained in such warehouse for a period not exceeding thirty days from the date of deposit.

DENATURED ALCOHOL.

Under such regulations as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may prescribe, the manufacture, warehousing, withdrawal, and shipment, under the provisions of existing law, of ethyl alcohol for other than (1) beverage purposes or (2) use in the manufacture or production of any article used or intended for use as a beverage, and denatured alcohol, may be exempted from the provisions of section thirty-two hundred and eighty-three, Revised Statutes of the United States.

Under such regulations as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may prescribe, manufacturers of ethyl alcohol for other than beverage purposes may be granted permission under the provisions of section thirty-two hundred and eighty-five, Revised Statutes of the United States, to fill fermenting tubs in a sweet-mash distillery not oftener than once in forty-eight hours.

IN HANDS OF DEALERS.

Sec. 303. That upon all distilled spirits produced in or imported into the United States upon which the tax now imposed by law has been paid, and which, on the day this Act is passed, are held by a retailer in a quantity in excess of fifty gallons in the aggregate, or by any other person, corporation, partnership, or association in any quantity, and which are intended for sale, there shall be levied, assessed, collected, and paid a tax of $1.10 (or, if intended for sale for beverage purposes or for use in the manufacture or production of any article used or intended for use as a beverage, a tax of $2.10) on each proof gallon, and a proportionate tax at a like rate on all fractional parts of such proof gallon: Provided, That the tax on such distilled spirits in the custody of a court of bankruptcy in insolvency proceedings on June first, nineteen hundred and seventeen, shall be paid by the person to whom the court delivers such distilled spirits at the time of such delivery, to the extent that the amount thus delivered exceeds the fifty gallons hereinbefore provided.

RECTIFIED SPIRITS.

Sec. 304. That in addition to the tax now imposed or imposed by this Act on distilled spirits there shall be levied, assessed, collected, and paid a tax of 15 cents on each proof gallon and a proportionate tax at a like rate on all fractional parts of such proof gallon on all distilled spirits of wines hereafter rectified, purified, or refined in such manner, and on all mixtures hereafter produced in such manner, that the person so rectifying, purifying, refining, or mixing the same is a rectifier within the meaning of section thirty-two hundred and forty-four, Revised Statutes, as amended, and on all such articles in the possession of the rectifier on the day this Act is passed: Provided, That this tax shall not apply to gin produced by the redistillation of a pure spirit over juniper berries and other aromatics.

When the process of rectification is completed and the tax prescribed by this section has been paid, it shall be unlawful for the rectifier or other dealer to reduce in proof or increase in volume such spirits or wine by the addition of water or other substance; nothing herein contained shall, however, prevent a rectifier from using again in the process of rectification spirits already rectified and upon which the tax has theretofore been paid.

The tax imposed by this section shall not attach to cordials or liqueurs on which a tax is imposed and paid under the Act entitled "An Act to increase the revenue, and for other purposes," approved September eighth, nineteen hundred and sixteen, nor to the mixing and blending of wines, where such blending is for the sole purpose of perfecting such wines according to commercial standards, nor to blends made exclusively of two or more pure straight whiskies aged in wood for a period not less than four years and without the addition of coloring or flavoring matter or any other substance than pure water and if not reduced below ninety proof: Provided, That such blended whiskies shall be exempt from tax under this section only when compounded under the immediate supervision of a revenue officer, in such tanks and under such conditions and supervision as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may prescribe.

All distilled spirits taxable under this section shall be subject to uniform regulations concerning the use thereof in the manufacture, blending, compounding, mixing, marking, branding, and sale of whisky and rectified spirits, and no discrimination whatsoever shall be made by reason of a difference in the character of the material from which same may have been produced.

The business of a rectifier of spirits shall be carried on, and the tax on rectified spirits shall be paid, under such rules, regulations, and bonds as may be prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury.

Any person violating any of the provisions of this section shall be deemed to be guilty of a misdemeanor and, upon conviction, shall be fined not more than $1,000 or imprisoned not more than two years. He shall, in addition, be liable to double the tax evaded together with the tax, to be collected by assessment or on any bond given.

STAMPS DISPENSED WITH.

Sec. 305. That hereafter collectors of internal revenue shall not furnish wholesale liquor dealer's stamps in lieu of and in exchange for stamps for rectified spirits unless the package covered by stamp for rectified spirits is to be broken into smaller packages.

The Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, is authorized to discontinue the use of the following stamps whenever in his judgment the interests of the Government will be subserved thereby:

Distillery warehouse, special bonded warehouse, special bonded rewarehouse, general bonded warehouse, general bonded retransfer, transfer brandy, export tobacco, export cigars, export oleomargarine and export fermented liquor stamps.

EQUIPMENT REQUIRED.

Sec. 306. That the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, is hereby authorized to require at distilleries, breweries, rectifying houses, and wherever else in his judgment such action may be deemed advisable, the installation of meters, tanks, pipes, or any other apparatus for the purpose of protecting the revenue, and such meters, tanks, and pipes and all necessary labor incident thereto shall be at the expense of the person, corporation, partnership, or association on whose premises the installation is required. Any such person, corporation, partnership, or association refusing or neglecting to install such apparatus when so required by the commissioner shall not be permitted to conduct business on such premises.

BEER AND OTHER FERMENTED LIQUORS.

Sec. 307. That on and after the passage of this Act there shall be levied and collected on all beer, lager beer, ale, porter, and other similar fermented liquor, containing one-half per centum or more of alcohol, brewed or manufactured and sold, or stored in warehouse, or removed for consumption or sale, within the United States, by whatever name such liquors may be called, in addition to the tax now imposed by law, a tax of $1.50 for every barrel containing not more than thirty-one gallons, and at a like rate for any other quantity or for the fractional parts of a barrel authorized and defined by law.

Sec. 308. That from and after the passage of this Act taxable fermented liquors may be conveyed without payment of tax from the brewery premises where produced to a contiguous industrial distillery of either class established under the Act of October third, nineteen hundred and thirteen, to be used as distilling material, and the residue from such distillation, containing less than one-half of one per centum of alcohol by volume, which is to be used in making beverages, may be manipulated by cooling, flavoring, carbonating, settling, and filtering on the distillery premises or elsewhere.

The removal of the taxable fermented liquor from the brewery to the distillery and the operation of the distillery and removal of the residue therefrom shall be under the supervision of such officer or officers as the Commissioner of Internal Revenue shall deem proper, and the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, is hereby authorized to make such regulations from time to time as may be necessary to give force and effect to this section and to safeguard the revenue.

WINES HEREAFTER REMOVED.

Sec. 309. That upon all still wines, including vermuth, and upon all champagne and other sparkling wines, liqueurs, cordials, artificial or imitation wines or compounds sold as wine, produced in or imported into the United States, and hereafter removed from the customhouse, place of manufacture, or from

bonded premises for sale or consumption, there shall be levied and collected, in addition to the tax now imposed by law upon such articles, a tax equal to such tax, to be levied, collected, and paid under the provisions of existing law.

IN HANDS OF DEALERS.

Sec. 310. That upon all articles specified in section three hundred and nine upon which the tax now imposed by law has been paid and which are on the day this Act is passed held in excess of twenty-five gallons in the aggregate of such articles and intended for sale, there shall be levied, collected, and paid a tax equal to the tax imposed by such section.

BRANDY FOR FORTIFICATION.

Sec. 311. That upon all grape brandy or wine spirits withdrawn by a producer of wines from any fruit distillery or special bonded warehouse under subdivision (c) of section four hundred and two of the Act entitled "An Act to increase the revenue, and for other purposes," approved September eighth, nineteen hundred and sixteen, there shall be levied, assessed, collected, and paid in addition to the tax therein imposed, a tax equal to double such tax, to be assessed, collected, and paid under the provisions of existing law.

EXTRA TAX ON SWEET WINES.

Sec. 312. That upon all sweet wines held for sale by the producer thereof upon the day this Act is passed there shall be levied, assessed, collected, and paid an additional tax equivalent to 10 cents per proof gallon upon the grape brandy or wine spirits used in the fortification of such wine, and an additional tax of 20 cents per proof gallon shall be levied, assessed, collected, and paid upon all grape brandy or wine spirits withdrawn by a producer of sweet wines for the purpose of fortifying such wines and not so used prior to the passage of this Act.

SIRUPS AND EXTRACTS.

Sec. 313. That there shall be levied, assessed, collected, and paid—

(a) Upon all prepared sirups or extracts (intended for use in the manufacture or production of beverages, commonly known as soft drinks, by soda fountains, bottling establishments, and other similar places) sold by the manufacturer, producer, or importer thereof, if so sold for not more than $1.30 per gallon, a tax of 5 cents per gallon; if so sold for more than $1.30 and not more than $2 per gallon, a tax of 8 cents per gallon; if so sold for more than $2 and not more than $3 per gallon, a tax of 10 cents per gallon; if so sold for more than $3 and not more than $4 per gallon, a tax of 15 cents per gallon; and if so sold for more than $4 per gallon, a tax of 20 cents per gallon; and

SOFT DRINKS.

(b) Upon all unfermented grape juice, soft drinks or artificial mineral waters (not carbonated), and fermented liquors containing less than one-half per centum of alcohol, sold by the manufacturer, producer, or importer thereof, in bottles or other closed containers, and upon all ginger ale, root beer, sarsaparilla, pop, and other carbonated waters or beverages, manufactured and sold by the manufacturer, producer, or importer of the carbonic acid gas used in carbonating the same, a tax of 1 cent per gallon; and

(c) Upon all natural mineral waters or table waters, sold by the producer, bottler, or importer thereof, in bottles or other closed containers, at over 10 cents per gallon, a tax of 1 cent per gallon.

Sec. 314. That each such manufacturer, producer, bottler, or importer shall make monthly returns under oath to the collector of internal revenue for the district in which is located the principal place of business, containing such information necessary for the assessment of the tax, and at such times and in such manner, as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may by regulation prescribe.

CARBONIC ACID GAS.

Sec. 315. That upon all carbonic acid gas in drums or other containers (intended for use in the manufacture or production of carbonated water or other

drinks) sold by the manufacturer, producer, or importer thereof, there shall be levied, assessed, collected, and paid a tax of 5 cents per pound. Such tax shall be paid by the purchaser to the vendor thereof and shall be collected, returned, and paid to the United States by such vendor in the same manner as provided in section five hundred and three.

THE WAR TAX ON CIGARS, TOBACCO, CIGARETTES

Title IV of the Act of October 3, 1917.

Cigars and Cigarettes.

Sec. 400. That upon cigars and cigarettes, which shall be manufactured and sold, or removed for consumption or sale, there shall be levied and collected, in addition to the taxes now imposed by existing law, the following taxes, to be paid by the manufacturer or importer thereof: (a) on cigars of all descriptions made of tobacco, or any substitute therefor, and weighing not more than three pounds per thousand, 25 cents per thousand; (b) on cigars made of tobacco, or any substitute therefor, and weighing more than three pounds per thousand, if manufactured or imported to retail at 4 cents, or more each, and not more than 7 cents each, $1 per thousand; (c) if manufactured or imported to retail at more than 7 cents each and not more than 15 cents each, $3 per thousand; (d) if manufactured or imported to retail at more than 15 cents each and not more than 20 cents each, $5 per thousand; (e) if manufactured or imported to retail at more than 20 cents each, $7 per thousand; Provided, That the word "retail" as used in this section shall mean the ordinary retail price of a single cigar, and that the Commissioner of Internal Revenue may, by regulation, require the manufacturer or importer to affix to each box or container a conspicuous label indicating by letter the clause of this section under which the cigars therein contained have been tax-paid, which must correspond with the tax-paid stamp on said box or container; (f) on cigarettes made of tobacco, or any substitute therefor, made in or imported into the United States, and weighing not more than three pounds per thousand, 80 cents per thousand; weighing more than three pounds per thousand, $1.20 per thousand.

Every manufacturer of cigarettes (including small cigars weighing not more than three pounds per thousand) shall put up all the cigarettes and such small cigars that he manufactures or has manufactured for him, and sells or removes for consumption or use, in packages or parcels containing five, eight, ten, twelve, fifteen, sixteen, twenty, twenty-four, forty, fifty, eighty, or one hundred cigarettes each, and shall securely affix to each of said packages or parcels a suitable stamp denoting the tax thereon and shall properly cancel the same prior to such sale or removal for consumption or use under such regulations as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe; and all cigarettes imported from a foreign country shall be packed, stamped, and the stamps canceled in a like manner, in addition to the import stamp indicating inspection of the customhouse before they are withdrawn therefrom.

TOBACCO AND SNUFF.

Sec. 401. That upon all tobacco and snuff hereafter manufactured and sold, or removed for consumption or use, there shall be levied and collected, in addition to the tax now imposed by law upon such articles, a tax of 5 cents per pound, to be levied, collected, and paid under the provisions of existing law.

In addition to the packages provided for under existing law, manufactured tobacco and snuff may be put up and prepared by the manufacturer for sale or consumption, in packages of the following description: Packages containing one-eighth, three-eighths, five-eighths, seven-eighths, one and one-eighth, one and three-eighths, one and five-eighths, one and seven-eighths, and five ounces.

NEW PACKAGES.

Sec. 402. That sections four hundred, four hundred and one, and four hundred and four, shall take effect thirty days after the passage of this Act: Provided, That after the passage of this Act and before the expiration of the aforesaid thirty days, cigarettes and manufactured tobacco and snuff may be put up in the packages now provided for by law or in the packages provided for in sections four hundred and four hundred and one.

HELD BY DEALERS.

Sec. 403. That there shall also be levied and collected, upon all manufactured tobacco and snuff in excess of one hundred pounds, or upon cigars, or cigarettes in excess of one thousand, which were manufactured or imported, and removed from factory or custom-house prior to the passage of this Act, bearing tax-paid stamps affixed to such articles for the payment of the taxes thereon, and which are, on the day after this Act is passed, held and intended for sale by any person, corporation, partnership, or association, and upon all manufactured tobacco, snuff, cigars, or cigarettes, removed from factory or customs house after the passage of this Act but prior to the time when the tax imposed by section four hundred or section four hundred and one upon such articles takes effect, an additional tax equal to one-half the tax imposed by such sections upon such articles.

CIGARETTE PAPERS.

Sec. 404. That there shall be levied, assessed, and collected upon cigarette paper made up into packages, books, sets, or tubes, made up in or imported into the United States and intended for use by the smoker in making cigarettes the following taxes: On each package, book, or set, containing more than twenty-five but not more than fifty papers, one-half of 1 cent; containing more than fifty but not more than one hundred papers, 1 cent; containing more than one hundred papers, 1 cent for each one hundred papers or fractional part thereof; and upon tubes, 2 cents for each one hundred tubes or fractional part thereof.

THE WAR TAX ON FREIGHT, EXPRESS, PASSENGER TRANSPORTATION, TELEGRAPH AND TELEPHONE MESSAGES AND INSURANCE.

Title V of the Act of October 3, 1917.

FREIGHT—EXPRESS—PASSENGER TICKETS—TELEGRAPH—TELEPHONE.

Sec. 500. That from and after the first day of November, nineteen hundred and seventeen, there shall be levied, assessed, collected, and paid (a) a tax equivalent to three per centum of the amount paid for the transportation by rail or water or by any form of mechanical motor power when in competition

with carriers by rail or water of property by freight consigned from one point in the United States to another; (b) a tax of 1 cent for each 20 cents, or fraction thereof, paid to any person, corporation, partnership, or association, engaged in the business of transporting parcels or packages by express over regular routes between fixed terminals, for the transportation of any package, parcel, or shipment by express from one point in the United States to another: Provided, That nothing herein contained shall be construed to require the carrier collecting such tax to list separately in any bill of lading, freight receipt, or other similar document, the amount of the tax herein levied, if the total amount of the freight and tax be therein stated; (c) a tax equivalent to eight per centum of the amount paid for the transportation of persons by rail or water, or by any form of mechanical motor power on a regular established line when in competition with carriers by rail or water, from one point in the United States to another or to any point in Canada or Mexico, where the ticket therefor is sold or issued in the United States, not including the amount paid for commutation or season tickets for trips less than thirty miles, or for transportation the fare for which does not exceed 35 cents, and a tax equivalent to ten per centum of the amount paid for seats, berths, and staterooms in parlor cars, sleeping cars, or on vessels. If a mileage book used for such transportation or accommodation has been purchased before this section takes effect, or if cash fare be paid, the tax imposed by this section shall be collected from the person presenting the mileage book, or paying the cash fare, by the conductor or other agent, when presented for such transportation or accommodation, and the amount so collected shall be paid to the United States in such manner and at such times as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may prescribe; if a ticket (other than a mileage book) is bought and partially used before this section goes into effect it shall not be taxed, but if bought but not so used before this section takes effect, it shall not be valid for passage until the tax has been paid and such payment evidenced on the ticket in such manner as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may by regulation prescribe; (d) a tax equivalent to a five per centum of the amount paid for the transportation of oil by pipe line; (e) a tax of 5 cents upon each telegraph, telephone, or radio, dispatch, message, or conversation, which originates within the United States, and for the transmission of which a charge of 15 cents or more is imposed: Provided, That only one payment of such tax shall be required, notwithstanding the lines or stations of one or more persons, corporations, partnerships, or associations shall be used for the transmission of such dispatch, message, or conversation.

PAID BY PATRONS.

Sec. 501. That the taxes imposed by section five hundred shall be paid by the person, corporation, partnership, or association paying for the services or facilities rendered.

In case such carrier does not, because of its ownership of the commodity transported, or for any other reason, receive the amount which as a carrier it would otherwise charge, such carrier shall pay a tax equivalent to the tax which would be imposed upon the transportation of such commodity if the carrier received payment for such transportation: Provided, That in case of a carrier which on May first, nineteen hundred and seventeen, had no rates or tariffs on file with the proper Federal or State authority, the tax shall be computed on the basis of the rates or tariffs of other carriers for like services as ascertained and determined by the Commissioner of Internal Revenue: Provided further, That nothing in this or the preceding section shall be construed as imposing a tax (a) upon the transportation of any commodity which is necessary for the use of the carrier in the conduct of its business as such and is intended to be so used or has been so used; or (b) upon the transportation of company material transported by one carrier, which constitutes a part of a railroad system, for another carrier which is also a part of the same system.

Sec. 502. That no tax shall be imposed under section five hundred upon any payment received for services rendered to the United States, or any State, Territory, or the District of Columbia. The right to exemption under this section shall be evidenced in such manner as the Commissioner of Internal Rev-

enue, with the approval of the Secretary of the Treasury, may by regulation prescribe.

MONTHLY RETURN AND PAYMENT.

Sec.503. That each person, corporation, partnership, or association receiving any payments referred to in section five hundred shall collect the amount of the tax, if any, imposed by such section from the person, corporation, partnership, or association making such payments, and shall make monthly returns under oath, in duplicate, and pay the taxes so collected and the taxes imposed upon it under paragraph two of section five hundred and one to the collector of internal revenue of the district in which the principal office or place of business is located. Such returns shall contain such information, and be made in such manner, as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may by regulation prescribe.

ON INSURANCE POLICIES.

Sec. 504. That from and after the first day of November, nineteen hundred and seventeen, there shall be levied, assessed, collected, and paid the following taxes on the issuance of insurance policies:

LIFE INSURANCE.

(a) Life insurance: A tax equivalent to 8 cents on each $100 or fractional part thereof of the amount for which any life is insured under any policy of insurance, or other instrument, by whatever name the same is called: Provided, That on all policies for life insurance only by which a life is insured not in excess of $500, issued on the industrial or weekly payment plan of insurance, the tax shall be forty per centum of the amount of the first weekly premium: Provided further, That policies of reinsurance shall be exempt from the tax imposed by this subdivision;

MARINE, INLAND AND FIRE INSURANCE.

(b) Marine, inland, and fire insurance: A tax equivalent to 1 cent on each dollar or fractional part thereof of the premium charged under each policy of insurance or other instrument by whatever name the same is called whereby insurance is made or renewed upon property of any description (including rents or profits), whether against peril by sea or inland waters, or by fire or lightning, or other peril: Provided, That policies of reinsurance shall be exempt from the tax imposed by this subdivision.

CASUALTY INSURANCE.

(c) Casualty insurance: A tax equivalent to 1 cent on each dollar or fractional part thereof of the premium charged under each policy of insurance or obligation of the nature of indemnity for loss, damage, or liability (except bonds taxable under subdivision two of schedule A of Title VIII) issued or executed or renewed by any person, corporation, partnership, or association, transacting the business of employer's liability, workmen's compensation, accident, health, tornado, plate glass, steam boiler, elevator, burglary, automatic sprinkler, automobile, or other branch of insurance (except life insurance, and insurance described and taxed in the preceding subdivision): Provided, That policies of reinsurance shall be exempt from the tax imposed by this subdivision;

THOSE EXEMPT.

(d) Policies issued by any person, corporation, partnership, or association, whose income is exempt from taxation under Title I of the Act entitled "An Act to increase the revenue, and for other purposes," approved September eighth, nineteen hundred and sixteen, shall be exempt from the taxes imposed by this section.

MONTHLY RETURN AND PAYMENT.

Sec. 505. That every person, corporation, partnership, or association, issuing policies of insurance upon the issuance of which a tax is imposed by section five hundred and four, shall, within the first fifteen days of each month,

make a return under oath, in duplicate, and pay such tax to the collector of internal revenue of the district in which the principal office or place of business of such person, corporation, partnership, or association is located. Such returns shall contain such information and be made in such manner as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may by regulation prescribe.

THE WAR EXCISE TAXES

On

MOTOR VEHICLES, MUSICAL INSTRUMENTS, PICTURE FILMS, JEWELRY, SPORTING GOODS, TOILET ARTICLES, PATENT MEDICINES, CAMERAS, CHEWING GUM AND BOATS.

Title VI of the Act of October 3, 1917.

AUTOMOBILES.

That there shall be levied, assessed, collected, and paid—

(a) Upon all automobiles, automobile trucks, automobile wagons, and motorcycles, sold by the manufacturer, producer, or importer, a tax equivalent to three per centum of the price for which so sold; and

MUSICAL INSTRUMENTS.

(b) Upon all piano players, graphophones, phonographs, talking machines, and records used in connection with any musical instrument, piano player, graphophone, phonograph, or talking machine, sold by the manufacturer, producer, or importer, a tax equivalent to three per centum of the price for which so sold; and

MOVING PICTURE FILMS.

(c) Upon all moving-picture films (which have not been exposed) sold by the manufacturer or importer, a tax equivalent to one-fourth of 1 cent per linear foot; and

(d) Upon all positive moving-picture films (containing a picture ready for projection) sold or leased by the manufacturer, producer, or importer, a tax equivalent to one-half of 1 cent per linear foot; and

JEWELRY.

(e) Upon any article commonly or commercially known as jewelry, whether real or imitation, sold by the manufacturer, producer, or importer thereof, a tax equivalent to three per centum of the price for which so sold; and

SPORTING GOODS.

(f) Upon all tennis rackets, golf clubs, baseball bats, lacrosse sticks, balls of all kinds, including baseballs, foot balls, tennis, golf, lacrosse, billiard and pool balls, fishing rods and reels, billiard and pool tables, chess and checker boards and pieces, dice, games and parts of games, except playing cards and children's toys and games, sold by the manufacturer, producer or importer, a tax equivalent to three per centum of the price for which so sold; and

TOILET ARTICLES.

(g) Upon all perfumes, essences, extracts, toilet waters, cosmetics, petroleum jellies, hair oils, pomades, hair dressings, hair restoratives, hair dyes, tooth and mouth washes, dentrifrices, tooth pastes, aromatic cachous, toilet soaps and powders, or any similar substance, article, or preparation by whatsoever name known or distinguished, upon all of the above which are used or applied or intended to be used or applied for toilet purposes, and which are sold by the manufacturer, importer, or producer, a tax equivalent to two per centum of the price for which so sold; and

PATENT MEDICINES.

(h) Upon all pills, tablets, powders, tinctures, troches or lozenges, sirups, medicinal cordials or bitters, anodynes, tonics, plasters, liniments, salves, ointments, pastes, drops, waters (except those taxed under section three hundred and thirteen of this Act), essences, spirits, oils, and all medicinal preparations, compounds, or compositions whatsoever, the manufacturer or producer of which claims to have any private formula, secret, or occult art for making or preparing the same, or has or claims to have any exclusive right or title to the making or preparing the same, or which are prepared, uttered, vended, or exposed for sale under any letters patent, or trade-mark, or which, if prepared by any formula, published or unpublished, are held out or recommended to the public by the makers, venders, or proprietors thereof as proprietary medicines or medicinal proprietary articles or preparations, or as remedies or specifics for any disease, diseases, or affection whatever affecting the human or animal body, and which are sold by the manufacturer, producer, or importer, a tax equivalent to two per centum of the price for which so sold; and

CHEWING GUM.

(i) Upon all chewing gum or substitute therefor sold by the manufacturer, producer, or importer, a tax equivalent to two per centum of the price for which so sold; and

CAMERAS.

(j) Upon all cameras sold by the manufacturer, producer, or importer, a tax equivalent to three per centum of the price for which so sold.

MONTHLY RETURN AND PAYMENT.

Sec. 601. That each manufacturer, producer, or importer of any of the articles enumerated in section six hundred shall make monthly returns under oath in duplicate and pay the taxes imposed on such articles by this title to the collector of internal revenue for the district in which is located the principal place of business. Such returns shall contain such information and be made at such times and in such manner as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may by regulations prescribe.

ARTICLES ON HAND.

Sec. 602. That upon all articles enumerated in subdivisions (a), (b), (e), (f), (g), (h), (i), or (j) of section six hundred, which on the day this Act is passed are held and intended for sale by any person, corporation, partnership, or association, other than (1) a retailer who is not also a wholesaler, or (2) the manufacturer, producer, or importer thereof, there shall be levied, assessed, collected, and paid, a tax equivalent to one-half the tax imposed by each such subdivision upon the sale of the articles therein enumerated. This tax shall be paid by the person, corporation, partnership, or association so holding such articles.

The taxes imposed by this section shall be assessed, collected, and paid in the same manner as provided in section ten hundred and two in the case of additional taxes upon articles upon which the tax imposed by existing law has been paid.

Nothing in this section shall be construed to impose a tax upon articles sold and delivered prior to May ninth, nineteen hundred and seventeen, where the title is reserved in the vendor as security for the payment of the purchase money.

YACHTS AND PLEASURE BOATS.

Sec. 603. That on the day this Act takes effect, and thereafter on July first in each year, and also at the time of the original purchase of a new boat by a user, if on any other date than July first, there shall be levied, assessed, collected, and paid, upon the use of yachts, pleasure boats, power boats, and sailing boats, of over five net tons, and motor boats with fixed engines, not used exclusively for trade or national defense, or not built according to plans and specifications approved by the Navy Department, an excise tax to be based on each yacht or boat, at rates as follows: Yachts, pleasure boats, power boats, motor boats with fixed engines, and sailing boats, of over five net tons, length not over fifty feet, 50 cents for each foot, length over fifty feet and not over one hundred feet, $1 for each foot, length over one hundred feet, $2 for each foot; motor boats of not over five net tons with fixed engines, $5.

In determining the length of such yachts, pleasure boats, power boats, motor boats with fixed engines, and sailing boats, the measurement of over-all length shall govern.

In the case of a tax imposed at the time of the original purchase of a new boat on any other date than July first, the amount to be paid shall be the same number of twelfths of the amount of the tax as the number of calendar months, including the month of sale, remaining prior to the following July first.

THE WAR TAX ON ADMISSIONS AND DUES.

Title VII of the Act of October 3, 1917.

ADMISSIONS TO THEATRES, ETC.

Sec. 700. That from and after the first day of November, nineteen hundred and seventeen, there shall be levied, assessed, collected, and paid (a) a tax of 1 cent for each 10 cents or fraction thereof of the amount paid for admission to any place, including admission by season ticket or subscription, to be paid by the person paying for such admission: Provided, That the tax on admission of children under twelve years of age where an admission charge for such children is made shall in every case be 1 cent; and (b) in the case of persons (except bona fide employees, municipal officers on official business, and children under twelve years of age) admitted free to any place at a time when and under circumstances under which an admission charge is made to other persons of the same class, a tax of 1 cent for each 10 cents or fraction thereof of the price so charged to such other persons for the same or similar accommodations, to be paid by the persons so admitted; and (c) a tax of 1 cent for each 10 cents or fraction thereof paid for admission to any public performance for profit at any cabaret or other similar entertainment to which the charge for admission is wholly or in part included in the price paid for refreshment, service, or merchandise; the amount paid for such admission to be computed under rules prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, such tax to be paid by the person paying for such refreshment, service, or merchandise. In the case of persons having the permanent use of boxes or seats in an opera house or any place of amusement or a lease for the use of such box or seat in such opera house or place of amusement there shall be levied, assessed, collected, and paid a tax equivalent to ten per centum of the amount for which a similar box or seat is sold for performance or exhibition at which the box is used or reserved by or

for the lessee or holder. These taxes shall not be imposed in the case of a place the maximum charge for admission to which is 5 cents, or in the case of shows, rides, and other amusements, (the maximum charge for admission to which is 10 cents) within outdoor general amusement parks, or in the case of admissions to such parks.

No tax shall be levied under this title in respect to any admissions all the proceeds of which inure exclusively to the benefit of religious, educational, or charitable institutions, societies, or organizations, or admissions to agricultural fairs, none of the profits of which are distributed to stockholders or members of the association conducting the same.

The term "admission" as used in this title includes seats and tables, reserved or otherwise, and other similar accommodations, and the charges made therefor.

CLUB DUES.

Sec. 701. That from and after the first day of November, nineteen hundred and seventeen, there shall be levied, assessed, collected, and paid, a tax equivalent to ten per centum of any amount paid as dues or membership fees (including initiation fees), to any social, athletic, or sporting club or organization, where such dues or fees are in excess of $12 per year; such taxes to be paid by the person paying such dues or fees: Provided, That there shall be exempted from the provisions of this section all amounts paid as dues or fees to a fraternal beneficiary society, order, or association, operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association or their dependents.

MONTHLY RETURN AND PAYMENT.

Sec. 702. That every person, corporation, partnership, or association (a) receiving any payments for such admission, dues, or fees, shall collect the amount of the tax imposed by section seven hundred or seven hundred and one from the person making such payments, or (b) admitting any person free to any place for admission to which a charge is made shall collect the amount of the tax imposed by section seven hundred from the person so admitted, and (c) in either case shall make returns and payments of the amounts so collected, at the same time and in the same manner as provided in section five hundred and three of this Act.

THE WAR STAMP TAXES

Title VIII of the Act of October 3, 1917.

DOCUMENTS AND ARTICLES.

Sec. 800. That on and after the first day of December, nineteen hundred and seventeen there shall be levied, collected, and paid, for and in respect of the several bonds, debentures, or certificates of stock and of indebtedness, and other documents, instruments, matters, and things mentioned and described in Schedule A of this title, or for or in respect of the vellum, parchment, or paper upon which such instruments, matters, or things, or any of them, are written or printed, by any person, corporation, partnership, or association who makes, signs, issues, sells, removes, consigns, or ships the same, or for whose use or benefit the same are made, signed, issued, sold, removed, consigned, or shipped, the several taxes specified in such schedule.

NOT SUBJECT TO TAX.

Sec. 801. That there shall not be taxed under this title any bond, note, or other instrument, issued by the United States, or by any foreign Government, or by any State, Territory, or the District of Columbia, or local subdivision thereof, or municipal or other corporation exercising the taxing power, when issued in the exercise of a strictly governmental, taxing, or municipal function; or stocks and bonds issued by cooperative building and loan associations which are organized and operated exclusively for the benefit of their members and make loans only to their shareholders, or by mutual ditch or irrigating companies.

PENALTY FOR VIOLATION.

That whoever—

(a) Makes, signs, issues, or accepts, or causes to be made, signed, issued, or accepted, any instrument, document, or paper of any kind or description whatsoever without the full amount of tax thereon being duly paid;

(b) Consigns or ships, or causes to be consigned or shipped, by parcel post any parcel, package, or article without the full amount of tax being duly paid;

(c) Manufactures or imports and sells, or offers for sale, or causes to be manufactured or imported and sold, or offered for sale, any playing cards, package, or other article without the full amount of tax being duly paid;

(d) Makes use of an adhesive stamp to denote any tax imposed by this title without canceling or obliterating such stamp as prescribed in section eight hundred and four;

Is guilty of a misdemeanor and upon conviction thereof shall pay a fine of not more than $100 for each offense.

Sec. 803. That whoever—fraudulently cuts, tears, or removes from any vellum, parchment, paper, instrument, writing, package, or article, upon which any tax is imposed by this title, any adhesive stamp or the impression of any stamp, die, plate, or other article provided, made, or used in pursuance of this title; (b) Fraudulently uses, joins, fixes, or places to, with, or upon any vellum, parchment, paper, instrument, writing, package, or article, upon which any tax is imposed by this title, (1) any adhesive stamp, or the impression of any stamp, die, plate, or other article, which has been cut, torn, or removed from any other vellum, parchment, paper, instrument, writing, package, or article, upon which any tax is imposed by this title or (2) any adhesive stamp or the impression of any stamp, die, plate, or other article of insufficient value; or (3) any forged or counterfeit stamp, or the impression of any forged or counterfeited stamp, die, plate, or other article;

(c) Willfully removes, or alters the cancellation, or defacing marks of, or otherwise prepares, any adhesive stamp, with intent to use, or cause the same to be used, after it has been already used, or knowingly or willfully buys, sells, offers for sale, or gives away, any such washed or restored stamp to any person for use, or knowingly uses the same;

(d) Knowingly and without lawful excuse (the burden of proof of such excuse being on the accused) has in possession any washed, restored, or altered stamp, which has been removed from any vellum, parchment, paper, instrument, writing, package, or article,

Is guilty of a misdemeanor, and upon conviction shall be punished by a fine of not more than $1,000, or by imprisonment for not more than five years, or both, in the discretion of the court, and any such reused, canceled, or counterfeit stamp and the vellum, parchment, document, paper, package, or article upon which it is placed or impressed shall be forfeited to the United States.

CANCELLATION OF STAMP.

Sec. 804. That whenever an adhesive stamp is used for denoting any tax imposed by this title, except as hereinafter provided, the person, corporation, partnership, or association, using or affixing the same shall write or stamp or cause to be written or stamped thereupon the initials of his or its name and the date upon which the same is attached or used, so that the same may not again be used: Provided, That the Commissioner of Internal Revenue may prescribe such other method for the cancellation of such stamps as he may deem expedient.

Sec. 805. (a) That the Commissioner of Internal Revenue shall cause to be prepared and distributed for the payment of the taxes prescribed in this title suitable stamps denoting the tax on the document, articles, or thing to which the same may be affixed, and shall prescribe such method for the affixing of said stamps in substitution for or in addition to the method provided in this title as he may deem expedient.

(b) The Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, is authorized to procure any of the stamps provided for in this title by contract whenever such stamps can not be speedily prepared by the Bureau of Engraving and Printing; but this authority shall expire on the first day of January, nineteen hundred and eighteen, except as to imprinted stamps furnished under contract, authorized by the Commissioner of Internal Revenue.

(c) All internal-revenue laws relating to the assessment and collection of taxes are hereby extended to and made a part of this title, so far as applicable, for the purpose of collecting stamp taxes omitted through mistake or fraud from any instrument, document, paper, writing, parcel, package, or article named herein.

SOLD BY POSTMASTERS.

Sec. 806. That the Commissioner of Internal Revenue shall furnish to the Postmaster General without prepayment a suitable quantity of adhesive stamps to be distributed to and kept on sale by the various postmasters in the United States. The Postmaster General may require each such postmaster to give additional or increased bond as postmaster for the value of the stamps so furnished, and each such postmaster shall deposit the receipts from the sale of such stamps to the credit of and render accounts to the Postmaster General at such times and in such form as he may by regulations prescribe. The Postmaster General shall at least once monthly transfer all collections from this source to the Treasury as internal-revenue collections.

SOLD AT U. S. DEPOSITORIES.

Sec. 807. That the collectors of the several districts shall furnish without prepayment to any assistant treasurer or designated depositary of the United States located in their respective collection districts a suitable quantity of adhesive stamps for sale. In such cases the collector may require a bond, with sufficient sureties, to an amount equal to the value of the adhesive stamps so furnished, conditioned for the faithful return, whenever so required, of all quantities or amounts undisposed of, and for the payment monthly of all quantities or amounts sold or not remaining on hand. The Secretary of the Treasury may from time to time make such regulations as he may find necessary to insure the safe-keeping or prevent the illegal use of all such adhesive stamps.

SCHEDULE A.—STAMP TAXES.

1. Bonds of indebtedness: Bonds, debentures, or certificates of indebtedness issued on and after the first day of December, nineteen hundred and seventeen, by any person, corporation, partnership, or association, on each $100 of face value or fraction thereof, 5 cents: Provided, That every renewal of the foregoing shall be taxed as a new issue: Provided further, That when a bond conditioned for the repayment or payment of money is given in a penal sum greater than the debt secured, the tax shall be based upon the amount secured.

2. **Bonds, Indemnity and Surety**: Bonds for indemnifying any person, corporation, partnership, or corporation who shall have become bound or engaged as surety, and all bonds for the due execution or performance of any contract, obligation, or requirement, or the duties of any office or position, and to account for money received by virtue thereof, and all other bonds of any description, except such as may be required in legal proceedings, not otherwise provided for in this schedule, 50 cents: Provided, That where a premium is charged for the execution of such bond the tax shall be paid at the rate of one per centum on each dollar or fractional part thereof of the premium charged: Provided further, That policies of reinsurance shall be exempt from the tax imposed by this subdivision.

3. **Capital stock, issue:** On each original issue, whether on organization or reorganization, of certificates of stock by any association, company, or corporation, on each $100 of face value or fraction thereof, 5 cents: Provided, That where capital stock is issued without face value, the tax shall be 5 cents per share, unless the actual value is in excess of $100 per share, in which case the tax shall be 5 cents on each $100 of actual value or fraction thereof.

The stamps representing the tax imposed by this subdivision shall be attached to the stock books and not to the certificates issued.

4. **Capital stock, sales or transfers:** On all sales, or agreements to sell, or memoranda of sales or deliveries of, or transfers of legal title to shares or certificates of stock in any association, company, or corporation, whether made upon or shown by the books of the association, company, or corporation, or by any assignment in blank, or by any delivery, or by any paper or agreement or memorandum or other evidence of transfer or sale, whether entitling the holder in any manner to the benefit of such stock or not, on each $100 of face value or fraction thereof, 2 cents, and where such shares of stock are without par value, the tax shall be 2 cents on the transfer or sale or agreement to sell on each share, unless the actual value thereof is in excess of $100 per share, in which case the tax shall be 2 cents on each $100 of actual value or fraction thereof: Provided, That it is not intended by this title to impose a tax upon an agreement evidencing a deposit of stock certificates as collateral security for money loaned thereon, which stock certificates are not actually sold, nor upon such stock certificates so deposited: Provided further, That the tax shall not be imposed upon deliveries or transfers to a broker for sale, nor upon deliveries or transfers by a broker to a customer for whom and upon whose order he has purchased same, but such deliveries or transfers shall be accompanied by a certificate setting forth the facts: Provided further, That in case of sale where the evidence of transfer is shown only by the books of the company the stamp shall be placed upon such books; and where the change of ownership is by transfer of the certificate the stamp shall be placed upon the certificate; and in cases of an agreement to sell or where the transfer is by delivery of the certificate assigned in blank there shall be made and delivered by the seller to the buyer a bill or memorandum of such sale, to which the stamp shall be affixed; and every bill or memorandum of sale or agreement to sell before mentioned shall show the date thereof, the name of the seller, the amount of the sale, and the matter or thing to which it refers. Any person or persons liable to pay the tax as herein provided, or anyone who acts in the matter as agent or broker for such person or persons who shall make any such sale, or who shall in pursuance of any such sale deliver any stock or evidence of the sale of any stock or bill or memorandum thereof, as herein required, without having the proper stamps affixed thereto with intent to evade the foregoing provisions shall be deemed guilty of a misdemeanor, and upon conviction thereof shall pay a fine of not exceeding $1,000, or be imprisoned not more than six months, or both, at the discretion of the court.

5. **Produce, sales of, on exchange:** Upon each sale, agreement of sale, or agreement to sell, including so-called transferred or scratch sales, any products or merchandise at any exchange, or board of trade, or other similar place, for future delivery, for each $100 in value of the merchandise covered by said sale or agreement of sale or agreement to sell, 2 cents, and for each additional $100 or fractional part thereof in excess of $100, 2 cents: Provided, That on every sale or agreement of sale or agreement to sell as aforesaid there shall be made and delivered by the seller to the buyer a bill, memorandum, agreement, or other evidence of such sale, agreement of sale, or agreement to sell, to which there shall be affixed a lawful stamp or stamps in value equal to the amount of the tax on such sale: Provided further, That sellers of commodities described herein, having paid the tax provided by this subdivision, may transfer such contracts to a clearing house corporation or association, and such transfer shall not be deemed to be a sale, or agreement of sale, or an agreement to sell within the provisions of this Act, provided that such transfer shall not vest any beneficial interest in such clearing house association but shall be made for the sole purpose of enabling such clearing house association to adjust and balance the accounts of the members of said clearing house association on their several contracts. And every such bill, memorandum, or other evidence of sale or

agreement to sell shall show the date thereof, the name of the seller, the amount of the sale, and the matter or thing to which it refers; and any person or persons liable to pay the tax as herein provided, or anyone who acts in the matter as agent or broker for such person or persons, who shall make any such sale or agreement of sale, or agreement to sell, or who shall, in pursuance of any such sale, agreement of sale, or agreement to sell, deliver any such products or merchandise without a bill, memorandum, or other evidence thereof as herein required, or who shall deliver such bill, memorandum, or other evidence of sale, or agreement to sell, without having the proper stamps affixed thereto, with intent to evade the foregoing provisions, shall be deemed guilty of a misdemeanor, and upon conviction thereof shall pay a fine of not exceeding $1,000, or be imprisoned not more than six months, or both, at the discretion of the court.

That no bill, memorandum, agreement, or other evidence of such sale, or agreement of sale, or agreement to sell, in case of cash sales of products or merchandise for immediate or prompt delivery which in good faith are actually intended to be delivered shall be subject to this tax.

6. **Drafts or checks payable otherwise than at sight** or on demand, promissory notes, except bank notes issued for circulation, and for each renewal of the same, for a sum not exceeding $100, 2 cents; and for each additional $100 or fractional part thereof, 2 cents.

7. **Conveyance: Deed,** instrument, or writing, whereby any lands, tenements, or other realty sold shall be granted, assigned, transferred, or otherwise conveyed to, or vested in, the purchaser or purchasers, or any other person or persons, by his, her, or their direction, when the consideration or value of the interest or property conveyed, exclusive of the value of any lien or encumbrance remaining thereon at the time of sale, exceeds $100 and does not exceed $500, 50 cents; and for each additional $500 or fractional part thereof 50 cents: Provided, That nothing contained in this paragraph shall be so construed as to impose a tax upon any instrument or writing given to secure a debt.

8. **Entry of any goods,** wares, or merchandise at any custom-house, either for consumption or warehousing, not exceeding $100 in value, 25 cents; exceeding $100 and not exceeding $500 in value, 50 cents; exceeding $500 in value, $1.

9. **Entry for the withdrawal** of any goods or merchandise from customs bonded warehouse, 50 cents.

10. **Passage ticket,** one way or round trip, for each passenger, sold or issued in the United States for passage by any vessel to a port or place not in the United States, Canada, or Mexico, if costing not exceeding $30, $1; costing more than $30 and not exceeding $60, $3; costing more than $60, $5: Provided, That such passage tickets, costing $10 or less, shall be exempt from taxation.

11. **Proxy for voting** at any election for officers, or meeting for the transaction of business, of any incorporated company or association, except religious, educational, charitable, fraternal, or literary societies, or public cemeteries, 10 cents.

12. **Power of attorney** granting authority to do or perform some act for or in behalf of the grantor, which authority is not otherwise vested in the grantee, 25 cents: Provided, That no stamps shall be required upon any papers necessary to be used for the collection of claims from the United States or from any State for pensions, back pay, bounty, or for property lost in the military or naval service or upon powers of attorney required in bankruptcy cases.

13. **Playing cards:** Upon every pack of playing cards containing not more than fifty-four cards, manufactured or imported, and sold, or removed for consumption or sale, after the passage of this Act, a tax of 5 cents per pack in addition to the tax imposed under existing law.

14. **Parcel-post packages:** Upon every parcel or package transported from one point in the United States to another by parcel post on which the postage amounts to 25 cents or more, a tax of 1 cent for each 25 cents or fractional part thereof charged for such transportation, to be paid by the consignor.

No such parcel or package shall be transported until a stamp or stamps representing the tax due shall have been affixed thereto.

THE WAR ESTATE TAX

Title IX of the Act of October 3, 1917.

Sec. 900. That in addition to the tax imposed by section two hundred and one of the Act entitled "An Act to increase the revenue, and for other purposes," approved September eighth, nineteen hundred and sixteen, as amended—

(a) A tax equal to the following percentages of its value is hereby imposed upon the transfer of each net estate of every decedent dying after the passage of this Act, the transfer of which is taxable under such section (the value of such net estate to be determined as provided in Title II of such Act of September eighth, nineteen hundred and sixteen):

One-half of one per centum of the amount of such net estate not in excess of $50,000;

One per centum of the amount by which such net estate exceeds $50,000 and does not exceed $150,000;

One and one-half per centum of the amount by which such net estate exceeds $150,000 and does not exceed $250,000;

Two per centum of the amount by which such net estate exceeds $250,000 and does not exceed $450,000;

Two and one-half per centum of the amount by which such net estate exceeds $450,000 and does not exceed $1,000,000;

Three per centum of the amount by which such net estate exceeds $1,000,000 and does not exceed $2,000,000;

Three and one-half per centum of the amount by which such net estate exceeds $2,000,000 and does not exceed $3,000,000;

Four per centum of the amount by which such net estate exceeds $3,000,000 and does not exceed $4,000,000;

Four and one-half per centum of the amount by which such net estate exceeds $4,000,000 and does not exceed $5,000,000;

Five per centum of the amount by which such net estate exceeds $5,000,000 and does not exceed $8,000,000;

Seven per centum of the amount by which such net estate exceeds $8,000,000 and does not exceed $10,000,000; and

Ten per centum of the amount by which such net estate exceeds $10,000,000.

MILITARY AND NAVAL EXEMPTION.

Sec. 901. That the tax imposed by this title shall not apply to the transfer of the net estate of any decedent dying while serving in the military or naval forces of the United States, during the continuance of the war in which the United States is now engaged, or if death results from injuries received or disease contracted in such service, within one year after the termination of such war. For the purposes of this section the termination of the war shall be evidenced by the proclamation of the President.

ADMINISTRATIVE AND GENERAL PROVISIONS OF WAR REVENUE ACT.

Title X and Title XIII of the Act of October 3, 1917.

Sec. 1000. That there shall be levied, collected, and paid in the United States, upon articles coming into the United States from the West Indian Is-

lands acquired from Denmark, a tax equal to the internal-revenue tax imposed in the United States upon like articles of domestic manufacture; such articles shipped from said islands to the United States shall be exempt from the payment of any tax imposed by the internal-revenue laws of said islands: Provided, That there shall be levied, collected, and paid in said islands, upon articles imported from the United States, a tax equal to the internal-revenue tax imposed in said islands upon like articles there manufactured; and such articles going into said islands from the United States shall be exempt from payment of any tax imposed by the internal-revenue laws of the United States.

Sec. 1001. That all administrative, special, or stamp provisions of law, including the law relating to the assessment of taxes, so far as applicable, are hereby extended to and made a part of this Act, and every person, corporation, partnership, or association liable to any tax imposed by this Act, or for the collection thereof, shall keep such records and render, under oath, such statements and returns, and shall comply with such regulations as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may from time to time prescribe.

Sec. 1002. That where additional taxes are imposed by this Act upon articles or commodities, upon which the tax imposed by existing law has been paid, the person, corporation, partnership, or association required by this Act to pay the tax shall, within thirty days after its passage, make return under oath in such form and under such regulations as the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury shall prescribe.

Payment of the tax shown to be due may be extended to a date not exceeding seven months from the passage of this Act, upon the filing of a bond for payment in such form and amount and with such sureties as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may prescribe.

Sec. 1003. That in all cases where the method of collecting the tax imposed by this Act is not specifically provided, the tax shall be collected in such manner as the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury may prescribe. All administrative and penalty provisions of Title VIII of this Act, in so far as applicable, shall apply to the collection of any tax which the Commissioner of Internal Revenue determines or prescribes shall be paid by stamp.

Sec. 1004. That whoever fails to make any return required by this Act or the regulations made under authority thereof within the time prescribed or who makes any false or fraudulent return, and whoever evades or attempts to evade any tax imposed by this Act or fails to collect or truly to account for and pay over any such tax, shall be subject to a penalty of not more than $1,000, or to imprisonment for not more than one year, or both, at the discretion of the court, and in addition theretc a penalty of double the tax evaded, or not collected, or accounted for and pai over, to be assessed and collected in the same manner as taxes are assessed and collected, in any case in which the punishment is not otherwise specifically provided.

Sec. 1005. That the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, is hereby authorized to make all needful rules and regulations for the enforcement of the provisions of this Act.

Sec. 1006. That where the rate of tax imposed by this Act, payable by stamps, is an increase over previously existing rates, stamps on hand in the collectors' offices and in the Bureau of Internal Revenue may continue to be used until the supply on hand is exhausted, but shall be sold and accounted for at the rates provided by this Act, and assessment shall be made against manufacturers and other taxpayers having such stamps on hand on the day this Act takes effect for the difference between the amount paid for such stamps and the tax due at the rates provided by this Act.

Sec. 1007. That (a) if any person, corporation, partnership, or association has prior to May ninth, nineteen hundred and seventeen, made a bona fide contract with a dealer for the sale, after the tax takes effect, of any article (or, in the case of moving-picture films, such a contract with a dealer, exchange, or exhibitor, for the sale or lease thereof) upon which a tax is imposed under Title

III, IV, or VI, or under subdivision thirteen of Schedule A of Title VIII, or under this section, and (b) if such contract does not permit the adding of the whole of such tax to the amount to be paid under such contract, then the vendee or lessee shall, in lieu of the vendor or lessor, pay so much of such tax as is not so permitted to be added to the contract price.

The taxes payable by the vendee or lessee under this section shall be paid to the vendor or lessor at the time the sale or lease is consummated, and collected, returned, and paid to the United States by such vendor or lessor in the same manner as provided in section five hundred and three.

The term "dealer" as used in this section includes a vendee who purchases any article with intent to use it in the manufacture or production of another article intended for sale.

Sec. 1008. That in the payment of any tax under this Act not payable by stamp a fractional part of a cent shall be disregarded unless it amounts to one-half cent or more, in which case it shall be increased to one cent.

Sec. 1009. That the Secretary of the Treasury, under rules and regulations prescribed by him, shall permit taxpayers liable to income and excess profits taxes to make payments in advance in installments or in whole of an amount not in excess of the estimated taxes which will be due from them, and upon determination of the taxes actually due any amount paid in excess shall be refunded as taxes erroneously collected: Provided, That when payment is made in installments at least one-fourth of such estimated tax shall be paid before the expiration of thirty days after the close of the taxable year, at least an additional one-fourth within two months after the close of the taxable year, at least an additional one-fourth within four months after the close of the taxable year, and the remainder of the tax due on or before the time now fixed by law for such payment: Provided further, That the Secretary of the Treasury, under rules and regulations prescribed by him, may allow credit against such taxes so paid in advance of an amount not exceeding three per centum per annum calculated upon the amount so paid from the date of such payment to the date now fixed by law for such payment; but no such credit shall be allowed on payments in excess of taxes determined to be due, nor on payments made after the expiration of four and one-half months after the close of the taxable year. All penalties provided by existing law for failure to pay tax when due are hereby made applicable to any failure to pay the tax at the time or times required in this section.

Sec. 1010. That under rules and regulations prescribed by the Secretary of the Treasury, Collectors of Internal Revenue may receive, at par and accrued interest, certificates of indebtedness issued under section six of the Act entitled "An Act to authorize an issue of bonds to meet expenditures for the national security and defense, and, for the purpose of assisting in the prosecution of the war, to extend credit to foreign governments, and for other purposes," approved April twenty-fourth, nineteen hundred and seventeen, and any subsequent Act or Acts, and uncertified checks in payment of income and excess profits taxes, during such time and under such regulations as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe; but if a check so received is not paid by the bank on which it is drawn the person by whom such check has been tendered shall remain liable for the payment of the tax and for all legal penalties and additions the same as if such check had not been tendered.

Sec. 1300. That if any clause, sentence, paragraph, or part of this Act shall for any reason be adjudged by any court of competent jurisdiction to be invalid, such judgment shall not affect, impair, or invalidate the remainder of said Act, but shall be confined in its operation to the clause, sentence, paragraph, or part thereof directly involved in the controversy in which such judgment shall have been rendered.

Sec. 1301. That Title I of the Act entitled, "An Act to provide increased revenue to defray the expenses of the increased appropriations for the Army and Navy and the extension of fortifications, and for other purposes," approved March third, nineteen hundred and seventeen, be and the same is hereby repealed.

Sec. 1302. That unless otherwise herein specially provided, this Act shall take effect on the day following its passage.

INDEX

INCOME TAX

Comment:

Unless otherwise indicated the references in this index are to paragraphs.

References, in brackets, to the text of the law, appearing in the Appendix, are by Appendix page number and Law Line number.

EXCESS PROFITS TAX

MISCELLANEOUS TAXES
